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APPENDIX A

William B. BLOUNT, Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION, Respondent,

Municipal Securities Rulemaking Board, Intervenor.

No. 94-1336

United States Court of Appeals,
District of Columbia Circuit.

Argued Dec. 9, 1994.

Decided Aug. 4, 1995.

Rehearing and Suggestion for Rehearing
In Banc Denied Oct. 4, 1995

On Petition for Review of an Order of the Securities and Exchange Commission.

Kevin T. Baine, Washington, DC, argued the cause, for petitioner. With him on the briefs, were Robert B. Barnett, Erik S. Jaffe, Lawrence Shore and Kevin M. Downey, Washington, DC.

Simon M. Lorne, Gen. Counsel, S.E.C., Washington, DC, argued the cause, for respondent. With him on the brief, were Jacob H. Stillman, Associate Gen. Counsel, and Eric Summergrad, Principal Asst. Gen. Counsel, S.E.C.,

Washington, DC. Paul Gonson, Washington, DC, entered an appearance, for respondent.

Harvey L. Pitt, Washington, DC, argued the cause, for intervenor. With him on the brief, was James H. Schropp, Washington, DC.

Before: WILLIAMS, HENDERSON and ROGERS, Circuit Judges.

STEPHEN F. WILLIAMS, Circuit Judge:

In late 1993, regulators of the municipal securities markets began to investigate reports that brokers and dealers were engaging in a variety of ethically questionable practices in order to secure underwriting contracts. These practices, often lumped together under the label "pay to play", include as a paradigmatic example the making of political contributions to state and local officials who may influence the choice of underwriter. Concerned that such practices were becoming more prevalent and were undermining the integrity of the $ 250 billion municipal securities market, the Municipal Securities Rulemaking Board ("MSRB" or "Board") drafted several new rules, which were then approved by the Securities and Exchange Commission. Among these was Rule G-37, the rule challenged in this case. See SEC Release No. 34-33868 (April 7, 1994) (order approving proposed rule change) ("*SEC Approval Order*").

The two principal sections of Rule G-37, (b) and (c), together restrict the ability of municipal securities professionals to contribute and to solicit contributions to the political campaigns of state officials from whom they obtain business. Section (d) serves as a loophole-closer, prohibiting

indirect violations of the restrictions in (b) or (c). We describe each in turn.

Contributions. Section (b) prohibits any "broker, dealer, or municipal securities dealer" who has contributed "to an official of [an] issuer" from "engaging in municipal securities business with [that] issuer" for a period of two years after the contribution.[1] Contributions by a "municipal finance professional associated" with the broker or dealer are treated as equivalent to contributions by the broker or dealer itself; as are contributions by a political action committee "controlled" either by the broker or dealer or by "any municipal finance professional" whatsoever. The two-year restriction on business is not triggered, however, by any of these various parties' contribution of up to $ 250 per official per election to an official for whom that party is entitled to vote.

Solicitations. Section (c) prohibits brokers, dealers, and municipal securities dealers—as well as their associated municipal finance professionals—from soliciting or coordinating contributions to officials of any issuer with whom the broker, etc., is "engaging or is seeking to engage in municipal securities business."

Loophole-closer. Section (d) prohibits brokers, dealers, municipal securities dealers, and municipal finance professionals in general from "directly or indirectly" doing

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[1] "Municipal securities business" is defined for most purposes as excluding issues based on competitive bids. See Rule G-37(g)(vii); see also *SEC Approval Order* at 16 n.41.

anything that would "result in a violation of sections (b) or (c) . . . ."

The petitioner, William B. Blount, is the chairman of the Alabama Democratic Party and a registered broker and dealer of municipal securities. He challenges the SEC's order approving Rule G-37, claiming that each of the three sections of the rule we have described impermissibly infringes his First Amendment rights; that section (d) is, in addition, unconstitutionally vague; and that the rule as a whole violates the Tenth Amendment. The SEC rebuts each of these claims, and the MSRB, as intervenor, raises two defenses not urged by the SEC: that Blount does not have standing under the Exchange Act to pursue his claim and that the rule is not the product of government action and thus cannot violate either the First or Tenth Amendments. We find that Blount has standing to sue and that Rule G-37 is government action. We therefore meet all of Blount's arguments on the merits, though ultimately we reject them and deny the petition for review.

I. Standing and Exhaustion

Neither the Board nor the SEC claims that Blount lacks constitutional or prudential standing, and given his roles as a state party chair and municipal securities dealer, any such claim would be meritless. Instead, the Board points to § 25(c)(1) of the Securities Exchange Act, 15 U.S.C. § 78y(c)(1), which requires that the objections in a petition for review have been "urged before the Commission", and argues that because Blount did not *himself* raise the present objections before the Commission, he is not a "person aggrieved" by the Commission's order within the meaning of § 25(a)(1) of the Securities Exchange Act, 15 U.S.C.

§ 78y(a)(1) (1988). We see nothing in either § 25(c)(1) or § 25(a)(1) that purports to link the two subsections together as the Board suggests. In addition, § 25(c)(1) conspicuously uses the passive voice, saying only that an objection may not be considered by a reviewing court unless it was "urged before the Commission"; it shows no interest in who urged the objection, and is presumably aimed only at assuring that the Commission have had a chance to address claims before being challenged on them in court. Cf. *NRDC v. EPA*, 824 F.2d 1146, 1150-51 (D.C.Cir.1987) (en banc).

The Commission indisputably had the necessary chance. The Board concedes that others raised and the SEC considered the "general constitutional objections to the Rule" that Blount now makes before us. See *SEC Approval Order* at 31-37 (considering constitutional objections). This quite accurate concession reduces the Board to the alternative argument that the SEC did not consider the "specific concerns identified by the Petitioner ... which arise from his particular status and duties as Chairman of the Alabama Democratic Party." While petitioner's activities may represent an unusually good example of the conduct the rule seeks to restrict, the Board does not explain, and we cannot see, how any of the issues the petitioner raises are in any salient way different from the concerns raised and considered during the rulemaking. Blount's claim is therefore not barred by the exhaustion requirement of § 25(c)(1).

II. Government Action

The Board maintains that it is a private organization and that Rule G-37 is a private rule. As such, the Board asserts, the rule cannot be found to violate the First or Tenth Amendments, since the Constitution is "a restraint on

government action, not that of private persons", *CBS v. Democratic Nat'l Comm.*, 412 U.S. 94, 114, 93 S.Ct. 2080, 2092, 36 L.Ed.2d 772 (1973) (plurality opinion).

We put to one side the Board's questionable assertion that it is a purely private organization even though it was created by an act of Congress and directed by Congress to "propose and adopt rules to effect the purposes of [the Exchange Act]" within specified constraints, § 78o-4(b)(2). Cf. *Lebron v. National R.R. Passenger Corp.*, — U.S. —, —, 115 S.Ct. 961, 973, 130 L.Ed.2d 902 (1995) (fact that Amtrak was created by federal law to accomplish federal governmental objectives points toward classification as federal actor). What is critical here is that MSRB Rule G-37 operates not as a private compact among brokers and dealers but as federal law. Under § 15B of the Exchange Act, a broker or dealer may not engage in interstate trade in municipal securities unless he registers under § 15B itself or under § 15 of the Exchange Act. See 15 U.S.C. § 78*o*-4(a)(1) (forbidding dealers to use "instrumentality of interstate commerce" to effect or solicit transactions in municipal securities unless registered as a broker or dealer in accordance with § 15 or § 15B, 15 U.S.C. § 78*o* or § 78*o*-4). If he violates an MSRB rule, he may be sanctioned by revocation or suspension of his license to deal in municipal securities. See *id.* § 78*o*-4(c)(1) (forbidding brokers and dealers from contravening the rules of the MSRB in effecting or soliciting interstate transactions in municipal securities); § 78*o*(b)(4)(D) (authorizing the Commission to suspend or revoke the registration of any broker or dealer who "has willfully violated" or "is unable to comply with" any of the applicable rules, including those of the MSRB); § 78*o*-4(c)(2) (similar authority as to municipal securities dealers). Dealers who violate Rule G-37 and who persist in securities dealing

after any resulting Commission suspension or revocation of their licenses are subject to federal criminal penalties. 15 U.S.C. § 78ff(a) (providing for criminal penalties up to $ 1,000,000 and 10-year imprisonment for natural persons who willfully violate rules). As a government-enforced condition to any participation in a municipal securities career, Rule G-37 constitutes government action of the purest sort.

III. First Amendment Challenge

We turn now to the central issue in this case, petitioner's claim that Rule G-37 violates his First Amendment rights to free speech and free association.

A. Rule G-37 as a restriction of speech

All three sections of Rule G-37 at issue here infringe speech. Giving money is one method of indicating one's devotion to a cause; hence the familiar challenge, "Put your money where your mouth is." The Supreme Court has characterized the campaign contribution as a "symbolic act" that "serves as a general expression of support for the candidate and his views", though noting at the same time that the contribution does not indicate the basis for the support and that a limit on contributions does not "infringe the contributor's freedom to discuss candidates and issues." *Buckley v. Valeo*, 424 U.S. 1, 21, 96 S.Ct. 612, 636, 46 L.Ed.2d 659 (1976) (per curiam); see also *Citizens Against Rent Control v. Berkeley*, 454 U.S. 290, 299, 102 S.Ct. 434, 438-39, 70 L.Ed.2d 492 (1981). Solicitation of campaign funds, the target of sections (c) and (d), is close to the core of protected speech, as it is "characteristically intertwined" with both information and advocacy and essential to the continued flow of both. *Village of Schaumburg v. Citizens*

for a Better Environment, 444 U.S. 620, 632, 100 S.Ct. 826, 833-34, 63 L.Ed.2d 73 (1980).

B. The requisite level of scrutiny

The intensity with which we scrutinize Rule G-37 depends on whether the rule is content-based, eliciting "strict" scrutiny, or content-neutral, eliciting only "intermediate" scrutiny. *Turner Broadcasting Sys., Inc. v. FCC*, — U.S. —, — - —, 114 S.Ct. 2445, 2458-59, 129 L.Ed.2d 497 (1994). The proper categorization of Rule G-37 is not clear-cut. As petitioner points out, under the everyday meaning of the word "content", the rule appears to be content-based, as it restricts only messages that concern one "topic", specifically, financial contributions to political campaigns. Cf., e.g., *McIntyre v. Ohio Elections Comm'n*, — U.S. —, —, 115 S.Ct. 1511, 1529-30, 131 L.Ed.2d 426 (1995); *Consolidated Edison Co. v. Public Serv. Comm'n of New York*, 447 U.S. 530, 537, 100 S.Ct. 2326, 2332-33, 65 L.Ed.2d 319 (1980). But the Supreme Court does not regard a rule's use of subject-based categories as automatically establishing it as content-based. The critical issue is whether the state's justification for the distinction is the "content" of the speech itself or some other concern:

> The principal inquiry in determining content neutrality . . . is whether the government has adopted a regulation of speech because of disagreement with the message it conveys . . . . Government regulation of expressive activity is content neutral so long as it is "*justified* without reference to the content of the regulated speech."

Ward v. Rock Against Racism, 491 U.S. 781, 791, 109 S.Ct. 2746, 2754, 105 L.Ed.2d 661 (1989) (quoting *Clark v. Community for Creative Non-Violence*, 468 U.S. 288, 294, 104 S.Ct. 3065, 3069, 82 L.Ed.2d 221 (1984)) (emphasis added). Compare, e.g., *Turner Broadcasting*, — U.S. at —, 114 S.Ct. at 2467 (content-neutral regulation), and *Renton v. Playtime Theatres, Inc.*, 475 U.S. 41, 106 S.Ct. 925, 89 L.Ed.2d 29 (1986) (same), with *City of Cincinnati v. Discovery Network, Inc.*, — U.S. —, —, 113 S.Ct. 1505, 1517, 123 L.Ed.2d 99 (1993) (content-based regulation), and *Boos v. Barry*, 485 U.S. 312, 108 S.Ct. 1157, 99 L.Ed.2d 333 (1988) (same).[2]

This regulation's goals could well be described as content-neutral. Contributions and solicitation of contributions have two aspects. They may communicate support for a candidate and his ideas, but they may also be used as the cover for what is much like a bribe: a payment that accrues to the private advantage of the official and is intended to induce him to exercise his discretion in the donor's favor, potentially at the expense of the polity he serves. The SEC clearly rested its approval of Rule G-37 on a wish to curtail this latter function. In language tracking that of § 15B of the Exchange Act, 15 U.S.C. § 78*o*-4, it

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[2] This methodology has come to replace the distinction between speech and conduct regulations originally articulated in *United States v. O'Brien*, 391 U.S. 367, 375, 88 S.Ct. 1673, 1678, 20 L.Ed.2d 672 (1968). See John Hart Ely, "Flag Desecration: A Case Study in the Roles of Categorization and Balancing in First Amendment Analysis", 88 Harv.L.Rev. 1482, 1496 (1975) (noting that the *O'Brien* Court itself adopts purpose test later in its opinion, "abandon[ing] its earlier suggestion that the constitutional answer can be found by examining O'Brien's act").

explained how the limits would, in its judgment, "prevent[] fraudulent and manipulative acts and practices, as well as the appearance of fraud and manipulation", *SEC Approval Order* at 26, perfect the mechanism of a free and open market for municipal securities, *id.* at 29, and "promote just and equitable principles of trade", *id.* at 30. Petitioner himself describes these goals as "nonspeech-related." Petitioner's Br. at 27 n.14.

These purposes are quite different from some of the ones that have triggered strict scrutiny in other cases involving political contributions. In *Buckley v. Valeo*, the interests "served by the Act include[d] restricting the voices of people and interest groups who have money to spend and reducing the overall scope of federal election campaigns", as well as "equalizing the relative ability of all voters to affect electoral outcomes". 424 U.S. at 17, 96 S.Ct. at 634. See also *id.* at 25-26, 96 S.Ct at 637-38 (referring to "ancillary" interest in "serv[ing] to mute the voices of affluent persons and groups in the election process and thereby to equalize the relative ability of all citizens to affect the outcome of elections."); *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652, 660, 110 S.Ct. 1391, 1397, 108 L.Ed.2d 652 (1990) (regulation said to target "corrosive and distorting effects of immense aggregations of wealth that are accumulated with the help of the corporate form and that have little or no correlation to the public's support for the corporation's political ideas"); *FEC v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238, 263, 107 S.Ct. 616, 630-31, 93 L.Ed.2d 539 (1986) (similar); *FEC v. National Right To Work Committee*, 459 U.S. 197, 207, 103 S.Ct. 552, 559, 74 L.Ed.2d 364 (1982) (similar). Thus the object in *Buckley* and the other campaign finance cases was not only, as here, to prevent *direct* quid pro quos (and the appearance thereof) but more

broadly to reduce the *indirect* impact of wealth on the electoral process, including the *persuasive impact* on both candidates and the public at large of messages communicated by the wealthy in that process. The Commission notes that in keeping with the difference in objectives, Rule G-37 is targeted narrowly to a concrete business relationship between the contributors and the candidates' governmental entities:

> Unlike general campaign financing restrictions, . . . which seek to combat unspecified forms of undue influence and political corruption, [these] conflict of interest provisions, . . . are tied to a contributor's business relationship with governmental entities and are intended to prevent fraud and manipulation.

SEC Approval Order at 34-35.

We are uncertain how much to make of this distinction. In *Buckley* the Court also said that "the primary interest served by the limitations . . . is the prevention of corruption . . . spawned by the real or imagined coercive influence of large financial contributions on candidates' positions and on their actions if elected to office." 424 U.S. at 25, 96 S.Ct. at 638. At no point did the Court suggest that it saw a great divide between efforts to foreclose corruption disguised as campaign contributions and more general efforts to limit the influence of wealth. Moreover, the principle that the Commission claims narrows the rule's purpose—its focus only on "business relations"—is subject in the full-blown modern interest-group state to very broad generalization. The class of people with "business relations to government entities" is plentiful, if we include all government employees; all government contractors; all who

benefit in their business from government activity creating a market for their goods or services (from lawyers specializing in SEC work to suppliers of environmental control technology); all whose businesses benefit from the imposition of regulatory, tax, or tariff restrictions on competitors or potential competitors; all whose income enjoys any kind of tax advantage; and all who are employed by or otherwise economically dependent on firms fitting the description above. The principle could also embrace anyone who (directly or through some group) is seeking to receive any such benefits and anyone seeking to stave off either the cancellation of existing benefits or the imposition of new burdens.

The only other basis for distinguishing the regulatory purposes asserted (and found to be content-based) in *Buckley* and its progeny from those asserted in this case is that the rules in the former cases were intended to safeguard the political process as a whole, whereas here the effort is to safeguard a commercial marketplace. But if the object of extirpating corruption—in the particular form of implicit exchanges between political contributions and politically allocated benefits—is content-based when the focus is on politics, we are uncertain why the object would be content-neutral when the focus is on the allocation of commercial benefits. In every case where a *quid* in the electoral process is being exchanged for a *quo* in a particular market where the government deals, the corruption in the market is simply the flipside of the electoral corruption.

Thus, although the purpose of preventing corrupt bond markets might logically be considered unrelated to the suppression of speech, our difficulty in distinguishing the purposes of this rule from those animating the rules at issue in *Buckley* and *Austin* makes us hesitate to find the rule

content-neutral. If the rule can withstand strict scrutiny there is no need to decide the issue. Accordingly we turn to applying such scrutiny and ask, following *Boos*, 485 U.S. at 321, 108 S.Ct. at 1163-64, and *Sable Communications v. FCC*, 492 U.S. 115, 126, 109 S.Ct. 2829, 2836-37, 106 L.Ed.2d 93 (1989), whether the rule is narrowly tailored to serve a compelling government interest.

C. Application of strict scrutiny

We divide the inquiry into three parts, addressing in turn (1) whether the interests the government proffers in support of the rule are properly characterized as "compelling"; (2) whether the rule effectively advances those interests, i.e., whether the Commission has shown that the ills it claims the rule addresses in fact exist and the rule will materially reduce them, *Turner Broadcasting*, — U.S. at —, 114 S.Ct. at 2470; and (3) whether the rule is narrowly tailored to advance the compelling interests asserted, i.e., whether less restrictive alternatives to the rule would accomplish the government's goals equally or almost equally effectively, *Sable Communications v. FCC*, 492 U.S. at 130-31, 109 S.Ct. at 2838-39. We conclude that the rule meets all three of these requirements.

1. Legitimate and compelling nature of interests asserted

Congress has charged the Commission and the MSRB to create rules

> to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, . . . to remove impediments to and perfect the mechanism of a free and

> open market . . ., and not . . . to permit unfair discrimination between . . . municipal securities brokers, or municipal securities dealers . . . .

15 U.S.C. § 78*o*-4(b)(2)(C). The Commission claims that Rule G-37 supports two interests encompassed within this mandate: (1) protecting investors in municipal bonds from fraud and (2) protecting underwriters of municipal bonds from unfair, corrupt market practices. Both of these interests are not only substantial, see *Turner Broadcasting*, —— U.S. at ——, 114 S.Ct. at 2470 ("[T]he Government's interest in eliminating restraints on fair competition is always substantial . . . .") (citing cases), but, we think, compelling. The Supreme Court has said that "preventing corruption or the appearance of corruption" is "the only legitimate and compelling government interest[] thus far identified for restricting campaign finances." *FEC v. National Conservative PAC*, 470 U.S. 480, 496-97, 105 S.Ct. 1459, 1468-69, 84 L.Ed.2d 455 (1985) (citing the holdings in *Buckley* and *Citizens Against Rent Control*). As we have already noted, in *Buckley* and *Austin* the legislature was interested in clean elections, whereas here the SEC is interested in clean bond markets. Petitioner insists on the importance of this distinction, saying that the latter interest is less compelling than the former. As we see it, however, one of the primary reasons people object to bought elections is that a bought politician tends to make distorted choices, and the public's concern about a particular type of distorted choice (the choice of bond underwriter) does not logically stand on a lower plane than its concern about bought politicians generally.

2. Tendency of the rule to further those interests

Petitioner also maintains that the Commission has failed to provide evidence sufficient to show "that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Turner Broadcasting*, — U.S. at —, 114 S.Ct. at 2470.[3] As a threshold matter, petitioner claims there is no support for the Commission's finding that pay-to-play practices are prevalent in the negotiated municipal bond business, because the record contains no evidence of specific instances of quid pro quos. But underwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity. Petitioner himself remarked on national radio that "most likely [state and local officials] are gonna call somebody who has been a political contributor" and, at least in close cases, award contracts to "friends" who have contributed. *Morning Edition* (National

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[3] We note petitioner's suggestion that the Commission's failure to support its findings with record evidence violates, in addition to the First Amendment, the Securities and Exchange Act, 15 U.S.C. §§ 78y(a)(4), 78y(b)(4) (rules must be supported by "findings . . . as to the facts" and "substantial evidence"), and the Administrative Procedure Act, see 5 U.S.C. § 706(2)(e); *Tex Tin Corp. v. EPA*, 992 F.2d 353, 356 (D.C.Cir.1993) (agency is not "entitled merely to assume" that the practices it seeks to regulate cause the harm it fears). Because the First Amendment requires us to scrutinize the factual basis for the regulation at least as stringently as these statutes, we see no need to address these contentions separately.

Public Radio, June 1, 1994), *available in* LEXIS, News Library, Transcript No. 1358-9. While the risk of corruption is obvious and substantial, actors in this field are presumably shrewd enough to structure their relations rather indirectly—indeed, the phrase "pay to play" suggests that a contribution brings the donor merely a chance to be seriously considered, not the assurance of a contract. As the Court said of quid pro quos for campaign contributions in *Buckley v. Valeo*, "the scope of such pernicious practices can never be reliably ascertained." 424 U.S. at 27, 96 S.Ct. at 638. In any event, the Commission observes that "[s]pecific abuses have been alleged in several state and local governments", *SEC Approval Order* at 8-11, and then cites newspaper clippings from 13 states and the District of Columbia with such headlines as "Kentucky Official Says He Served as Middleman to Solicit Funds", from *The Bond Buyer*, September 7, 1993. Although the record contains only allegations, no smoking gun is needed where, as here, the conflict of interest is apparent, the likelihood of stealth great, and the legislative purpose prophylactic. See *FEC v. National Right to Work Committee*, 459 U.S. 197, 210, 103 S.Ct. 552, 560-61, 74 L.Ed.2d 364 (1982) (Court will not "second-guess a legislative determination as to the need for prophylactic measures where corruption is the evil feared.").

Even assuming the prevalence of quid pro quos, Blount maintains, the Commission has not demonstrated that eliminating such activity advances the asserted interests in protecting investors and promoting just and equitable principles of trade. As to the harm to investors, we tend to share the petitioner's skepticism. The Commission reasoned that pay-to-play practices make underwriters "less likely or competent to perform a reasonable investigation of statements made by the issuer in connection with the offering". *SEC*

Approval Order at 27-28. The Commission points to no data supporting the idea, and it is anything but self-evident. Two interests seem to give the underwriter an incentive to exercise due diligence in investigating municipal issuers: its interest in averting liability for fraud, see *SEC Approval Order* at 26 n. 54 (noting that securities laws impose on underwriters a legal duty to investigate), and its interest in safeguarding its reputation among bond buyers and their representatives. Neither interest would be diminished merely by an underwriter's use of sleazy means to secure the contract. And while an implicit (or even explicit) offer to refrain from investigating thoroughly might well help an underwriter win a negotiated contract, it would help regardless of whether the underwriter also used other means of ingratiating himself with the powers that be.

On the other hand, the link between eliminating pay-to-play practices and the Commission's goals of "perfecting the mechanism of a free and open market" and promoting "just and equitable principles of trade" is self-evident. The Commission explained:

> "Pay to play" practices raise artificial barriers to competition for those firms that either cannot afford or decide not to make political contributions. Moreover, if "pay to play" is the determining factor in the selection of an underwriting syndicate, an official may not necessarily hire the most qualified underwriter for the issue. . . . "Pay to play" practices undermine [just and equitable] principles [of trade] since underwriters working on a particular issuance may be assigned similar roles, and take on equivalent risks, but be

> given different allocations of bonds to sell—resulting in differing profits—based on their political contributions or contacts.

See *SEC Approval Order* at 29-30. Moreover, there appears to be a collective action problem tending to make the misallocation of resources persist. As beneficiaries of the practice, politicians vying for state or local office may be reluctant to stop it legislatively; some, of course, may seek to exploit their rivals' cozy relation with bond dealers as a campaign issue, but if they refuse to enter into similar relations, their campaigns will be financially handicapped. Bond dealers are in a still worse position to initiate reform: individual firms that decline to pay will have less chance to play, and may even be the object of explicit boycott if they do. See "Politicians Are Mobilizing to Derail Ban on Muni Underwriters", *Wall St. J.*, Dec. 27, 1993, at C16 (reporting that Florida Association of Counties called for a boycott of 17 firms that had voluntarily banned political contributions).

Even if the regulation does advance the asserted interests, Blount says, it should be stricken as underinclusive. He points out that the prohibitions on contributions and on solicitation of contributions obviously will not eliminate *all* possible methods by which underwriters may curry favor. Municipal finance professionals remain free, for example, to solicit votes or contribute time and talents to a campaign effort. He also notes that the limitations of Rule G-37 do not apply to chief executive officers of banks with municipal securities departments or subsidiaries.

But a regulation is not fatally underinclusive simply because an alternative regulation, which would restrict *more* speech or the speech of *more* people, could be more effective.

The First Amendment does not require the government to curtail as much speech as may conceivably serve its goals. While the rule chosen must "fit" the asserted goals, *City of Cincinnati*, — U.S. at —, 113 S.Ct. at 1516, it must also, by virtue of the narrow tailoring requirement discussed below, strike an appropriate balance between achieving those goals and protecting constitutional rights. Because the primary purpose of underinclusiveness analysis is simply to "ensure that the proffered state interest actually underlies the law", *Austin*, 494 U.S. at 677, 110 S.Ct. at 1407 (Brennan, J., concurring), a rule is struck for *under*inclusiveness only if it cannot "fairly be said to advance any genuinely substantial governmental interest", *FCC v. League of Women Voters*, 468 U.S. 364, 396, 104 S.Ct. 3106, 3126, 82 L.Ed.2d 278 (1984), because it provides only "ineffective or remote" support for the asserted goals, *id.* (citing *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n*, 447 U.S. 557, 564, 100 S.Ct. 2343, 2350, 65 L.Ed.2d 341 (1980)), or "limited incremental" support, *Bolger v. Youngs Drug Prods. Corp.*, 463 U.S. 60, 73, 103 S.Ct. 2875, 2883-84 77 L.Ed.2d 469 (1983). See also *Florida Star v. B.J.F.*, 491 U.S. 524, 109 S.Ct. 2603, 105 L.Ed.2d 443 (1989) (government "must demonstrate its commitment to advancing [its] interest by applying its prohibition evenhandedly. . . . Without more careful and inclusive precautions against alternative forms of [the harm], we cannot conclude that Florida's selective ban . . . satisfactorily accomplishes its stated purpose."). Thus, with regard to First Amendment *under*inclusiveness analysis, neither a perfect nor even the best available fit between means and ends is required.[4]

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[4] Petitioner tosses into his opening brief a footnote (continued...)

In citing the Commission's failure to cover the CEOs of banks with municipal securities departments as evidence of fatal underinclusiveness, petitioner invokes *Carey v. Brown*, 447 U.S. 455, 471, 100 S.Ct. 2286, 2295-96, 65 L.Ed.2d 263 (1980), which he reads as requiring a "substantial interest" to justify a class's *exemption* from a speech restriction (under an equal protection analysis). Even assuming that that is a correct reading of *Carey*, the decision clearly related to an exemption based on the *content* of the subject's expression (labor matters), see *id.*, and petitioner makes no claim that content played any role whatever in the Commission's exclusion of bank CEOs.

We have already explained why and how we think the provisions of Rule G-37 at issue can be expected materially to advance compelling interests asserted by the Commission. The Commission has explained that the "loopholes" that remain are due to its "sensitivity" to First Amendment

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[4](...continued)
contending that the Commission's failure to make Rule G-37 applicable to bank officers and bank-controlled political action committees makes for disparate treatment that violates not only the First Amendment but also the due process clause of the *Fifth* Amendment. We find it unnecessary to evaluate this contention. The Fifth Amendment requires only that the government have a rational basis for its distinction, see, e.g., *Vance v. Bradley*, 440 U.S. 93, 109, 99 S.Ct. 939, 948-49, 59 L.Ed.2d 171 (1979) ("Rather than abandoning its primary end completely, or unnecessarily including all federal employees within the means, it drew a line around those groups of employees it thought most generally pertinent to its objective."); and rational-basis review requires, if anything, *less* "mathematical nicety", *id.* at 109, 99 S.Ct. at 948-49, than the First Amendment requires.

concerns; it believes that closing the supposed loopholes would broaden the regulation's scope beyond that "necessary" to accomplish its interests. In other words, the Commission adjudged the risk of corruption in the conduct left unrestrained too remote to warrant restraint. In our view, petitioner has pointed to nothing that calls that judgment into serious question.

3. Narrow tailoring

Blount asserts that Rule G-37 is too broad, arguing that the Commission could have achieved its goal with less restrictive means. Specifically, he claims, it could have confined itself to disclosure and record-keeping requirements (which the Commission instituted in Rule G-37(e) and Rules G-8 and G-9); or, at worst, to those requirements plus the contribution limits of Rule G-37(b). In other words, the Commission probably had no need to curtail *contributions*, Rule G-37(b), and certainly had no need to curtail *solicitation* of contributions, Rule G-37(c).

If the Commission's goals were only to protect the investing public, disclosure and record-keeping requirements might do the job. Informed investors—insofar as they believe contributors are less likely to investigate issuers or more likely to overprice issues—could use the disclosed information to avoid buying bond issues underwritten by campaign contributors. As we pointed out above, however, it is not at all clear that investors are harmed or even perceive themselves to be harmed when underwriters obtain business through shady practices. Thus disclosure would not likely cause market forces to erode "pay to play", and the Commission's other grounds for objecting to the practice would go unmet. Just as the Court in *Buckley v. Valeo* said

that Congress could have found disclosure "only a partial measure", 424 U.S. at 28, 96 S.Ct. at 639, so here the Commission could reasonably find it inadequate. Moreover, without the prohibitions of sections (c) and (d) on soliciting contributions, directly or indirectly, underwriters could easily circumvent the prohibition against direct contributions. Not only would the Commission's purpose of protecting the integrity of the market for underwriting services most certainly "be achieved less effectively", *Ward*, 491 U.S. at 799, 109 S.Ct. at 2758, without the limits on campaign contributions and solicitation, but none of the alternatives presented would be even *almost* equally effective. Cf. *Sable Communications v. FCC*, 492 U.S. at 130-31, 109 S.Ct. at 2838-39 (narrow tailoring requirement not met when the record suggests a less restrictive and possibly "extremely effective" alternative); *Boos*, 485 U.S. at 329, 108 S.Ct. at 1168 (requirement not met when there is evidence that Congress itself "no longer considers this statute necessary" to meet the stated objective and when "a less restrictive alternative is readily available").

Finally, the regulation is "closely drawn" and thus "avoid[s] unnecessary abridgement" of First Amendment rights, *Buckley v. Valeo*, 424 U.S. at 25, 96 S.Ct. at 638. Rule G-37 constrains relations only between the two potential parties to a quid pro quo: the underwriters and their municipal finance employees on the one hand, and officials who might influence the award of negotiated municipal bond underwriting contracts on the other.[5] Even then, the rule

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[5] The rule does not apply to underwriting business awarded on a competitive basis, that is, "offerings in which the securities are awarded to the underwriting syndicate presenting the best bid (continued...)

restricts a narrow range of their activities for a relatively short period of time. The underwriter is barred from engaging in business with the particular issuer for only two years after it makes a contribution, and it is barred from soliciting contributions only during the time that it is engaged in or seeking business with the issuer associated with the donee. A municipal finance professional may contribute up to $250 per election to each official for whom he or she is entitled to vote, without triggering the business bar. Furthermore, as the Commission interprets the rule, municipal finance professionals are not in any way restricted from engaging in the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events. *SEC Approval Order* at 19 ("proposal will not restrict personal volunteer work . . . in political campaigns other than soliciting or coordinating contributions"); *id.* at 36 ("proposal does not restrict uncoordinated independent expenditures"); SEC Release No. 33870 (Apr. 7, 1994) ("*SEC Order Denying Preliminary Stay*") at 8 (ban on solicitation applies only to "explicit solicitations of contributions, and not to generalized

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[5](...continued)
according to stipulated criteria set forth in the notice of sale." *SEC Approval Order* at 16 n. 41; see also Rule G-37(g)(vii)(A). Although the rule might be interpreted as applying to private placement or advisory service business awarded on a competitive basis, see Rule G-37(g)(vii)(B) and (C), none of the parties mentions this possibility, and petitioner does not contend that he engages in such business. It is therefore unnecessary for us to address the constitutionality of those parts of the rule. See *Burson v. Freeman*, 504 U.S. 191, 210 n. 13, 112 S.Ct. 1846, 1857 n. 13, 119 L.Ed.2d 5 (1992).

solicitations of support for a candidate or his views."); SEC Release No. 34008 (May 4, 1994) ("*SEC Order Denying Stay*") at 12 ("[A]pplicant's concern that the provision could be triggered by inadvertently using the word 'money' in a speech urging support for a candidate, or simply by making a speech of general support at a fund-raising affair, is misplaced. Likewise, his contention that soliciting money for his political party will necessarily trigger the provision is incorrect."); but cf. *id.* at 6 (noting that Blount's complaint is that the rule will prevent him from directing contributed funds to particular state officials, which is normally a duty of the party chairman, and appearing to assume that the rule will have the feared effect).

IV. Vagueness

Petitioner argues that section (d), prohibiting anyone from "directly or indirectly, through or by any other person or means" doing what sections (b) and (c) prohibit, is unconstitutionally vague and in violation of his due process rights under the Fifth Amendment. See, e.g., *Timpinaro v. SEC*, 2 F.3d 453, 460 (D.C.Cir.1993) ("A vague rule denies due process by imposing standards of conduct so indeterminate that it is impossible to ascertain just what will result in sanctions.") (citation and internal quotation marks omitted); see also *Hynes v. Mayor & Council of Oradell*, 425 U.S. 610, 619, 96 S.Ct. 1755, 1760, 48 L.Ed.2d 243 (1976) ("The general test of vagueness applies with particular force in review of laws dealing with speech. . . . [A] man may less be required to act at his peril here, because the free dissemination of ideas may be the loser.") (citation and internal quotation marks omitted).

Although the language of section (d) itself is very broad, the SEC has interpreted it as requiring a showing of culpable intent, that is, a demonstration that the conduct was undertaken "as a means to circumvent" the requirements of (b) and (c). *SEC Approval Order* at 19; see also *SEC Order Denying Stay* at 6 n. 7 (prohibition only affects Blount's family to the degree that "he is directing their contributions, thus seeking to evade the rule's provisions"). The SEC states its "means to circumvent" qualification in general terms. The qualification appears, therefore, to apply not only to such items as contributions made by the broker's or dealer's family members or employees, but also to gifts by a broker to a state or national party committee, made with knowledge that some part of the gift is likely to be transmitted to an official excluded by Rule G-37. In short, according to the SEC, the rule restricts such gifts and contributions only when they are intended as end-runs around the direct contribution limitations.

Moreover, the Commission has substantially reduced any remaining uncertainty about the rule's potential application by providing for informal advance rulings from SEC staff on any proposed course of conduct, *see* 17 CFR §§ 202.1(d) & 202.2. This helps protect underwriters against the sort of risk that the constitutional rule against vagueness seeks to constrain. See *Civil Service Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548, 580, 93 S.Ct. 2880, 2897-98, 37 L.Ed.2d 796 (1973) (taking existence of such a procedure into account). And, of course, if the SEC actually brings an enforcement action, the affected party may challenge the particular application of the rule as not reasonably foreseeable under the rule's language. See, e.g., *General Elec. Co. v. EPA*, 53 F.3d 1324, 1330 (D.C.Cir.1995) (agency's interpretation of a rule, though

permissible, may yet be "so far from a reasonable person's understanding" of what the rule might mean that the rule cannot be said to give the "fair notice" necessary for due process).

V. Tenth Amendment Challenge

Finally, petitioner claims that Rule G-37 is an effort to regulate state election campaigns and, as such, usurps the states' power to control their own elections. This contention is meritless. Rule G-37 neither compels the states to regulate private parties, as the Tenth Amendment prohibits, *New York v. United States*, 505 U.S. 144, 112 S.Ct. 2408, 120 L.Ed.2d 120 (1992), nor regulates the states directly, a question on which the Supreme Court's Tenth Amendment jurisprudence "has traveled an unsteady path", *id.* at 160, 112 S.Ct. at 2420. Further, the rule does not have anything resembling the kind of preemptive effect on states' ability to control their own election processes that might be perceived as "destructive of state sovereignty". See *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 554, 105 S.Ct. 1005, 1019, 83 L.Ed.2d 1016 (1985); cf. *Gregory v. Ashcroft*, 501 U.S. 452, 460-62, 111 S.Ct. 2395, 2401, 115 L.Ed.2d 410 (1991). Blount points to no theory of the Tenth Amendment or the commerce clause under which Congress is disabled from regulating private persons in their conduct of interstate trade in municipal securities, see 15 U.S.C. § 78*o*-4(a)(1), so we need not proceed further. See generally *United States v. Lopez*, — U.S. —, 115 S.Ct. 1624, 131 L.Ed.2d 626 (1995).

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Because Rule G-37 withstands all of Blount's challenges, the petition for review is

Denied.

APPENDIX B

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-33868; File No. SR-MSRB-94-2)

April 7, 1994

Self-Regulatory Organizations: Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business and Notice of Filing and Order Approving on an Accelerated Basis Amendment No. 1 Relating to the Effective Date and Contribution Date of the Proposed Rule

On January 12, 1994, the Municipal Securities Rulemaking Board ("MSRB") submitted to the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-MSRB-94-02) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,[1] and Rule 19b-4 thereunder. The MSRB filed the proposal to adopt rules relating to political contributions and prohibitions on municipal securities business. The Commission published notice of the proposal in the Federal Register on January 21, 1994.[2] On February 4, 1994, the Commission extended the comment period for the proposal by 30 days, to March 11, 1994.[3] On March 29, 1994, the MSRB filed an Amendment

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1 15 U.S.C. § 78s(b)(1).

2 Securities Exchange Act Release No. 33482 (January 14, 1994), 59 FR 3389.

3 Securities Exchange Act Release No. 33583 (February 4, 1994), 59 FR 6320.

to the proposal relating to the proposal's effective date and contribution date.[4]

The Commission received 69 comments letters on the proposed rule change. Twenty-four commentators favor the proposal and 33 oppose the proposal. Several commentators raise concerns without expressly favoring or opposing the proposal. Several commentators that favor the proposal make recommendations to better enable municipal securities dealers to comply with the proposal. The Commission has determined, for the reasons discussed below, to approve the proposed rule change.

I. Executive Summary

The MSRB's proposed rule change relating to political contributions and prohibitions on municipal securities business is intended to address practices known as "pay to play." These practices typically involve payments in the form of political contributions to help finance election campaigns of state or local officials or similar arrangements with these officials. Widespread reports regarding the existence of such

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[4] As originally submitted, the proposal's prohibitions on municipal securities business would arise from contributions made on or after April 1, 1994. The MSRB filed an amendment to change the April 1, 1994 date to a date 10 days after publication in the Federal Register of the Commission order approving the proposal. The MSRB also amended the proposal to change the effective date of the proposal's disclosure and recordkeeping requirements to a date 10 days after publication of the approval order in the Federal Register. File No. SR-MSRB-94-2, Amendment No. 1 (March 29, 1994).

practices has fueled industry and regulatory concerns. These practices directly affect municipal securities markets by increasing costs borne by issuers, dealers and ultimately investors, by creating artificial barriers to competition, and by undermining underwriter and market integrity. In 1993, state and local governments awarded negotiated underwriting contracts for the sale of more than $250 billion of municipal bonds, approximately 80% of all municipal securities underwritings, to facilitate the construction of schools, highways, hospitals, public housing, bridges, water and sewer systems, and other infrastructure projects needed to serve public needs and spur local and regional economic growth.[5] As of December 31, 1993, private investors, including households and mutual and money market funds, held more than $850 billion in municipal securities, representing approximately 70% of outstanding municipal securities.[6] While it is difficult to quantify the cost of fraudulent, unethical, and manipulative dealer selection practices, at a minimum, these practices substantially undermine the integrity of the municipal securities market. Congress recognized the importance of integrity in municipal securities financing when it directed the formation of the MSRB, as part of the Securities Acts Amendments of 1975, and authorized the MSRB to regulate the conduct of municipal securities dealers to, among other things, prevent fraudulent and manipulative acts and practices, promote just and equitable principles of

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5 See Public Securities Association, Review of Studies of Competitive and Negotiated Financing of Municipal and Corporate Securities, (March 1994).

6 Board of Governors of the Federal Reserve System, Flow of Funds Accounts, Flows and Outstandings, Fourth Quarter 1993 (March 9, 1994) ("Flow of Funds Accounts").

trade, remove impediments to free and open trade, and protect investors and the public interest.

As the self-regulatory organization ("SRO") charged with primary oversight of municipal securities dealers' activities, the MSRB has proposed a series of measures designed to prevent "pay to play" practices in the awarding of municipal securities business. These measures include a prohibition against municipal securities dealers, conducting certain types of municipal securities business with an issuer if the dealer or affiliated persons, subject to exceptions, made political contributions to officials of the issuer who could influence the awarding of that business. The measures also include separate provisions requiring municipal securities dealers to maintain records and to disclose aggregate information to facilitate compliance and examinations with the goal of promoting investor confidence in the integrity of the municipal securities market. As discussed below, the Commission believes that the proposal is consistent with the Act and will advance the goals of the Act.

II. Background

The market for municipal securities is characterized by great diversity and high volume and comprises an estimated 50,000 issuers including state governments, cities, towns, counties, and special subdivisions, such as special purpose districts and public authorities.[7] There are approximately 1.3 million municipal securities issues outstanding, representing

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[7] Securities and Exchange Commission, Division of Market Regulation, Staff Report on the Municipal Securities Market, (September 1993) ("Municipal Securities Report") at 1.

over $1.2 trillion in securities.[8] In 1993, 17,000 new issues took place with a record value of $335 billion.[9] As discussed below, negotiated underwritings have become the predominate method of underwriter selection. The MSRB's proposal is designed to address abuses involving political contributions inherent in using negotiated underwriting as a method of underwriter selection.

A. Increasing Use of Negotiated Underwriting

The types of securities generally issued by municipalities include general obligation bonds (secured by the full faith and credit and general taxing power of the issuer), revenue bonds (secured by the revenues of particular project), and conduit bonds (securities issues to finance a project that is to be used in the trade or business of a third party, typically a private corporation or non-profit entity). At one time general obligation bonds were most prevalent. Today, however, most offerings consist of revenue bonds. During the past few years, the municipal bond market also

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[8] See Flow of Funds Accounts, supra note 6.

[9] This record financing was heavily influences by refundings. Nevertheless, the level of long term new money financing, representing 49% of the financing for the year, reflected continued market growth. In 1993, there were $142 billion of new money long term financings, compared to $81 billion in 1988, a 75% increase. "A decade of Municipal Finance," The Bond Buyer (Jan. 6, 1994) at 24. See also Securities Act Release No. 7049, Securities Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748, and Securities Exchange Act Release No 33742, (March 9, 1994), 59 FR 12759.

has experience a proliferation of complex derivative products.[10]

Although competitive bidding traditionally has been used for public financing,[11] in recent years negotiated underwritings have become much more common.[12] In 1993,

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10 Among these are principal and interest strips, pooled municipal investment vehicles, detachable call options, and new variable rate securities.

11 At the time the Exchange Act was enacted, competitive bidding, in one form or another, was the most accepted method of financing used by municipalities and other public entities. L. Loss & J. Seligman, Securities Regulation 343 (1989). In competitive offerings, the issuer decides who will underwrite its bonds based almost entirely on price in response to the issuers "notice of sale." Firms wishing to bid on an issue will include other firms in their syndicates based on their marketing or capital needs and the requirements of the issuer, if any. Some issuers will require the underwriting syndicate to include one or more firms with significant minority participation or specific regional capacity. This requirement usually is stated in the notice of sale. See MSRB, Glossary of Municipal Terms, (1985), definition of "competitive bid" or "competitive bidding."

12 There can be an element of competition present in negotiated deals. In a negotiated offering, the issuer typically distributes a request for proposals ("RFP") to provide underwriting services for either a single issue, or more frequently, for a set period of years. Underwriters that are interested then submit their responses and the issuer will select one or more of the respondents to provide

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negotiated underwritings accounted for approximately 80% of all long-term municipal bond offerings.

Competitive bidding offers the public some protection against the exertion of inappropriate influence on public officials by municipal underwriters. When bidding is done

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[12](...continued)

underwriting services. Issuers commonly select the entire management group in a negotiated offering, and often select most members of the selling group as well. Often an issuer will use the RFP process to "pre-qualify" a pool of underwriters as eligible to provide services and then select specific underwriters on a transaction by transaction basis. Consequently, the RFP process may not purge the selection process of undue influence. Notwithstanding the use of an RFP, issuers may award the municipal securities business according to existing non-merit based relationships with an underwriter.

In a large syndicate, one or more firms will serve as senior syndicate managers or co-managers; a second tier of firms will be designated as managers; the remaining syndicate members are the selling group. The issuer will also designate which of the managers will actually "run the books" and manage the syndicate. The senior managers and managers bear a risk of loss; members of the selling group do not bear this risk. Some issuers may select all the firms and delineate the position of each; others choose several firms as the management group, and give the senior syndicate managers discretion to choose members of the selling group (or name a few selling group members, and allow the senior managers to choose the remainder); still others will choose a senior manager and no others and the manager may or may not form a selling group.

competitively and publicly, there is less possibility of collusion and political patronage. Because the competitive process offers all potential bidders equal opportunity to be awarded the deal, bidders must compete with one another based on the pricing of the issue and the willingness to accept market risk.[13]

In contrast to competitive underwritings, negotiated underwritings present greater risk of abuse in the underwriter selection process.[14] Issuers may become involved not only in selecting the lead underwriter, but also in controlling other provisions of the distribution. Selection may be based on non-meritorious considerations, creating a genuine risk that

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13 The Government Finance Officers Association ("GFOA") cites three advantages to competitive sales: assurance that the bonds are sold at the lowest cost in the prevailing market; lower gross underwriting spreads than negotiated sales, historically; and promotion of the appearance of an open, fair process. "Taxpayers have greater assurance that the bonds have been awarded at the lowest possible cost, and not for the benefit of underwriting forms engaged in political activities to support elected officials." An Elected Official's Guide to Debt Issuance, Kurish and Tigue, GFOA, Chicago, IL (1993) ("Elected Officials Guide").

14 Negotiated sales do present advantages. GFOA notes three: ability to delegate tasks such as document preparation, sizing and structuring to the underwriter; pre-sale period in which structure may be tailored to investor demand; and flexibility to respond to market conditions. Elected Officials Guide. See also Public Securities Association, Review of Studies of Competitive and Negotiated Financing of Municipal and Corporate Securities, (March 1994).

underwriters will be selected on the basis of political influence rather than the quality of the underwriter's services in distributing the securities.[15]

B. "Pay to Play"

Recent reports regarding "pay to play" have raised concerns about the practices municipal securities dealers employ to obtain municipal securities business. There have been numerous reported instances where registered municipal securities dealers, their employees, and related parties, allegedly have made payments, political contributions, or entered into business ventures with political figures apparently to obtain the underwriting business of municipal securities issuers. Specific abuses have been alleged in several state and local governments including Alabama,[16] California,[17] Colorado[18] the District of Columbia,[19] Florida,[20]

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15 Regardless of whether an issue is competitive or negotiated, most issuers also employ financial advisers to assist in a bond offering. While some financial advisers are chosen on an issue by issue basis, others are retained to assist the issuer over a period of time. Financial advisers also are paid by the issuer, and their fees may be considered an expense of the offering.

16 "Crying Cronyism" Lawmaker seeks Alabama Ban on Negotiated Deals," The Bond Buyer, (February 7, 1994), at 1.

17 "Curbs Sought on Bond Firm contributions," The Washington Post, (January 14, 1994) at B2.

18 "The Politics of Money," U.S. News and World Report, (September 20, 1993), at 67.

Illinois,[21] Kentucky,[22] Massachusetts,[23] Michigan,[24] New

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[19](...continued)

[19] "Lazard Pushed D.C. to Arrange Swaps with Merrill Lynch, D.C. Official says," The Bond Buyer, (January 19, 1994), at 1; "Lazard Partner Says Firm Unaware of Ferber's Bid to Share D.C. Fees," The Bond Buyer, (January 20, 1994), at 1; "Cracking the 'Club' that Controls the Muni Bond Market," The Washington Post, (November 21, 1993), at H1.

[20] "The Bond Merchants: Wall Street Makes Millions on Municipal Bonds But Guess Who Pays?" Common Cause Magazine, (October 1993).

[21] "Chicago Confirms Being Subpoenaed by Grand Jury in Ferber Inquiry," The Bond Buyer, (January 13, 1994) at 1; "Illinois Measure Would Restrict Campaign Giving by Bond Dealers," The Bond Buyer, (February 4, 1994), at 1; "Push to Curb Donations Not So Simple," The Chicago Tribune, (November 17, 1993), at 1.

[22] "At Trial, Kentucky's Bill Collins Gets Final Say as Prosecutors Hammer Away at the Gift Piano," The Bond Buyer (October 11, 1993) at 1; "Kentucky Official Says He Served a Middleman to Solicit Funds," The Bond Buyer, September 7, 1993), at 1. Bill Collins is the husband of the former governor of Kentucky, Martha Layne Collins. On October 14, 1993, following a jury trial in the United States District Court for the Eastern District of Kentucky, he was convicted of extortion and conspiracy.

[23] "Treasurer's Office in Massachusetts Confirms Existence of Investigations," The Bond Buyer, (February 7, 1994), at 1; "Massachusetts Bars Merrill From Top Bond-Sale Role," The Wall Street Journal, (February 7, 1994), at C19;

(continued...)

Jersey,[25] New York,[26] Ohio,[27] Oklahoma,[28] and

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[23](...continued)
"Latest Accusations Leveled Against Ferber Provide New Details on 1990 MIFA Deal"," The Bond Buyer, (December 21, 1993), at 1; "FEDs Subpoena MIFA for Second Time; Bond Documents Since 1982 Sought," The Bond Buyer, (January 27, 1994); "Papers Show New Links Between Ferber, Firm," The Boston Globe, (December 17, 1993), at 1.

[24] "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2.

[25] "Lazard Freres, Merrill Lynch Fee Spitting Livens Debate," The Bond Buyer, (June 25, 1993), at 1; "New Jersey Turnpike, Merrill Lynch at Center of U.S. Attorney Probe," The Bond Buyer, (April 29, 1993), 1; "N.J. Governor Bans Negotiated Underwriting at State Level," The Bond Buyer, (May 5, 1993), at 1; "Turnpike Officials Said Lazard Called the Shots," The Bond Buyer, (May 26, 1993), at 1; "Ferber Investigators Said to Pick Up Pace; Lazard Freres Subpoenaed, Others Wait," The Bond Buyer, (November 23, 1993), at 1.

[26] "Holtzman Dials Direct for Dollars, asking Bankers to Help Pay Off Debt," The Bond Buyer (May 12, 1993), at 1; "Wall Street Executives Appear on List of Fund Raiser for N.Y. Comptroller," The Bond Buyer (October 29, 1993), at 1; "Get Off McCall's Committee," The Bond Buyer (November 1, 1993), at 42; "NYC's Stein Urges Mayor, Comptroller to copy New Jersey, Ban Negotiated Debt," The Bond Buyer, (May 12, 1993), at 1; "N.Y.C. Report Slams Holtzman for Negligence in Fleet Affair,". The Bond Buyer, (September 16, 1993), at 1; "The Trouble with
(continued...)

Wisconsin.[29] The widespread nature of the complaints concerning abuses has received considerable attention from Congress, the Commission, the MSRB, the securities industry, the media, and the public, reflecting concerns regarding the integrity, fairness, and sound operation of the municipal securities market.

C. Regulation of Municipal Securities Underwritings

It appears that "pay to play" practices are considered by many municipal securities dealers to be an ordinary cost

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[26](...continued)
Consultants, the Market May be Getting Serious About Campaign Contributions, But There's More Ways to Peddle Influence," The Bond Buyer, (November 16, 1993), at 1; "Holtzman Says Loan Didn't Sway Choice of Fleet to Handle New York City Debt," The Bond Buyer, (April 26, 1993), at 1.

[27] "Armacon's Ohio Work A Smith Barney Favor After 1991 Lease Issue Soured in New Jersey," The Bond Buyer, (May 17, 1993), at 1.

[28] "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2; "SEC Investigates Oklahoma Issues for Possible Law Violations," The Bond Buyer, (November 23, 1993), at 1; "SEC Inspects Pike Bond Refinancing," The Daily Oklahoman, (November 19, 1993), at 1; "SEC Asks Agencies in Oklahoma for Data About Bond Issues," The Wall Street Journal, (November 24, 1993), at A5.

[29] "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2.

associated with obtaining municipal underwriting business.[30] The widespread perception of such practices calls into question the integrity of the municipal securities market and the business practices some municipal underwriters utilize in order to obtain underwriting contracts. Several reports have suggested that the greatest cost of improper contributions is the cost to investors, taxpayers, and the public at large.[31]

As a result of reports alleging improper payments regarding the New Jersey Turnpike refunding, in May 1993, Congress requested the Commission, the MSRB, and the National Association of Securities Dealers ("NASD") to review the adequacy of regulation and oversight of the municipal securities market.[32] This culminated in the Division's Municipal Securities Report,[33] and Congressional

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30 "Illegal Payments Mar the Muni Market," The Wall Street Journal, (May 5, 1993), at C1.

31 "Bond Buyers' Gains, Taxpayers' Loss," New York Times, (September 5, 1993), at 11; "The Trouble with Munis, the Market is Sound, But Abuses Hurt Both Investors and Taxpayers," Business Week, (September 6, 1993), at 44.

32 Letter from the Honorable John D. Dingell, Chairman, Committee on Energy and Commerce, United States House of Representative, and The Honorable Edward J. Markey, Chairman, Subcommittee on Energy and Commerce, United States House of Representatives, to Mary L. Schapiro, Acting Chairman, Commission, Christopher A. Taylor, Executive Director, MSRB, and Joseph R. Hardiman, President and Chief Executive Officer, NASD (May 24, 1993).

33 Supra note 7.

hearings on the municipal securities market held on September 9, 1993. The Municipal Securities Report recommended that "pay to play" contributions be addressed promptly.[34] The Staff stated that an MSRB proposal to require disclosure of political contributions and limiting campaign contributions for the purpose of obtaining underwriting business represented a positive first step to address the misuse of political contributions.[35]

The MSRB's efforts to examine the role of political contributions in the underwriting process pre-date recent public interest in the issue. In August 1991, the MSRB published a notice expressing concern that the process of selecting an underwriting team should not be influenced by political contributions, and encouraged underwriters, and state and local governments to maintain the integrity of the underwriter selection process.[36] In May 1993, the MSRB issued a press release noting continued concern by the MSRB,

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34 The Commission's Chairman Arthur Levitt testified that, "[w]hile the Commission remains confident of the strength and effectiveness of the municipal securities market, we also share the Subcommittee's concern that investor confidence in its integrity may have been impaired as a result of recent serious allegations of abusive practices." Testimony of Arthur Levitt, Chairman, Commission, Concerning the State of the Municipal Securities Market, Before the Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, United States House of Representatives (September 9, 1993).

35 Municipal Securities Report, supra note 7, at 33.

36 See MSRB Report, Vol. 11, No. 3, (September 1991) at 11.

industry members, and others regarding political contributions.[37]

In August 1993, the MSRB published for comment draft Rule G-37 ("August 1993 draft rule").[38] Although the majority of commentators supported the MSRB proposal, none gave unqualified support. After considering the commentators' concerns and suggestions at its November and December 1993 meetings, the MSRB proposed the instant rule change.

Some state officials and politicians have advocated or introduced legislation aimed at abuse resulting from political contributions and have made attempts to reform the municipal securities underwriter selection process.[39] Voluntary industry

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37 See MSRB Reports, Vol. 13, No. 3, (June 1993) at 15.

38 The draft proposal would have (1) prohibited brokers, dealers and municipal securities dealers and their associated persons from making political contributions, directly or indirectly, to officials of issuers for the purpose of obtaining or retaining municipal securities business, and (2) required dealers and their associated persons to disclose, for a four-year period, all political contributions to officials of such issuers with whom they have done business.

39 E.g., House No, 1824, The Commonwealth of Massachusetts (a recently introduced bill to prohibit political contributions by investment bankers and bond counsel); The Commonwealth of Massachusetts Joint Statement on Debt Policy (issued to "[r]eaffirm and extend the statutory presumption that all Commonwealth Debt . . . shall be issued on a competitive, sealed-bid (lowest true (continued...)

efforts also are underway to reduce the presence of inappropriate political influence peddling. On October 18, 1993, seventeen municipal securities dealers agreed to adopt a "Statement of Initiative," providing that political contributions made, in any manner, for the purpose of influencing the awarding of municipal finance business should

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[39](...continued)

interest cost) basis and establish standards for rebutting that presumption . . .; [e]stablish a basic framework for the establishment of procurement process for the selection of underwriters, financial advisors and attorneys . . .; [and] [f]urther the practice of requiring disclosure by underwriters, financial advisors and attorneys which fosters the elimination of conflicts of interest among those which serve the Commonwealth . . . in . . . issuances of debt."). The Commonwealth of Massachusetts Treasury Department (October 27, 1993).

See also "Crying Cronyism, Lawmaker Seeks Alabama Ban on Negotiated Deals," The Bond Buyer, (February 7, 1994), at 1; "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2; "Shapiro of Maine Seeks MSRB Ban on Political Contributions from Bond Firms," The Bond Buyer, (May 14, 1993), at 1; N.J. Governor Bans Negotiated Underwriting at State Level," The Bond Buyer, (May 5, 1993), at 1; "Following SEC, Texas Authority Seeks Disclosure on Political Gifts," The Bond Buyer, (June 23, 1993), at 1; "Massachusetts Bars Merrill From Top Bond Sale Role," The Wall Street Journal, (February 7, 1994), at C19; "Municipal Bond Group Urges End to Being Solicited," The Wall Street Journal, (October 8, 1993), at C1.

be prohibited. To date, over 50 firms have agreed to adhere to the Statement of Initiative.[40]

While the Commission views the voluntary efforts of those firms adhering to the Statement of Initiative as laudable, these actions represent only a first step. The MSRB's proposed rule change marks a second step: industry-wide reform intended to respond to the detrimental effects of conflicts of interest.

III. Description

The proposed rule change would establish industry-wide restrictions and requirements aimed at preventing fraudulent and manipulative practices, promoting just and equitable principles of trade, removing impediments to free and open trade, and protecting investors and the public interest. The MSRB's proposal is intended to address the real as well as perceived abuses resulting from "pay to play" practices in the municipal securities market. The proposal is a comprehensive scheme composed of several separate requirements affecting municipal securities dealers, including limitations on business activities triggered by political contributions, limitations on solicitation and coordination of

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40 Some state and local officials have stated their intention to boycott those firms that voluntarily stop political contributions. The Florida Association of Counties, for example, called for its members to boycott seventeen securities firms that have voluntarily banned political contributions citing these firms' endorsement of "public policy damaging rules." See "Politicians are Mobilizing to Derail Ban on Muni Underwriters' Campaign Gifts," The Wall Street Journal, (December 27, 1993), at C16.

political contributions, and dealer recordkeeping and disclosure.

A. Rule G-37—"Pay to Play" Restrictions

1. Business Disqualification Provision. Proposed rule G-37 will prohibit brokers, dealers and municipal securities dealers ("dealers") from engaging in municipal securities business with an issuer within two years after proscribed contributions made by (1) the dealer, (2) any municipal finance professional associated with the dealer or (3) any political action committee ("PAC") controlled by the dealer or any such associated municipal finance professional, to an official of the issuer who can, directly or indirectly, influence the awarding of municipal securities business "Municipal securities business" includes certain dealer activities such as the purchase of primary offering of municipal securities from the issuer on other than a competitive bid basis (i.e., acting as a managing underwriter or as a syndicate member in negotiated underwritings), and acting as a financial advisor, consultant, placement agent, or negotiated remarketing agent.[41] The proposal defines an "official of an issuer" as any incumbent, candidate or successful candidate for elective office of the issuer, which office is directly or indirectly responsible for, or can influence

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[41] The proposed rule does not apply to competitive bids, i.e., offerings in which the securities are awarded to the underwriting syndicate presenting the best bid according to stipulated criteria set forth in the notice of sale. See Glossary of Municipal Terms, supra note 11. Obviously, there is potential for abuse in determining the criteria y which eligibility is determined. If such abuse occurs, we would expect the MSRB to respond appropriately.

the outcome of, the hiring of a dealer for municipal securities business. This includes any issuer official, incumbent or candidate (or successful candidate) who has influence over the awarding of municipal securities business. "Contributions" include any gift, subscription, loan, advance, or deposit of money or anything of value made: (1) for the purpose of influencing any election of any official of a municipal securities issuer for federal, state,[42] or local office; (2) for payment or reduction of debt incurred in connection with any election; or (3) for transition or inaugural expenses incurred by the successful candidate for state or local office.

Thus, contributions to certain state-wide executive or legislative officials will affect the eligibility of the firm to engage in municipal securities business.[43] The proposal applies to contributions made on or after [insert date 10 days after publication in the Federal Register].[44]

The proposal's disqualification provision also would be triggered by contributions from employees of dealers, defined as "municipal finance professionals," are primarily engaged in municipal securities business. The proposal exempts contributions made by municipal finance

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42 The term "state" is defined in Section 3(a)(16) of the Act to mean any sate of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States.

43 For example, governors will be included under the proposal's definition of official of an issuer.

44 File No. SR-MSRB-94-2, Amendment No. 1 (March 29, 1994). See supra note 4.

professionals of $250 or less per election to each official for whom the term "municipal finance professional" to mean: (1) any associated person primarily engaged in municipal securities representative activities, as defined in rule G-3(a)(i),[45] (2) any associated person who solicits municipal securities business; (3) any direct supervisor of such persons up through and including, in the case of a dealer other than a bank dealer, the chief executive officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a); or (4) any member of the dealer executive or management committee or similarly situated officials, if any (or, in the case of a bank dealer, similarly situated officials in

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[45] Rule G-3(a)(i) defines the term "municipal securities representative" as a person associate with a dealer, other than a person whose functions are solely clerical or ministerial, whose activities include one or more of the following: (A) underwriting, trading or sales of municipal securities; (B) financial advisory or consultant services for issuers in connection with the issuance of municipal securities; (C) research or investment advice with respect to municipal securities; or (D) any other activities which involve communication, directly or indirectly, with public investors in municipal securities; provided, however, that the activities enumerated in subparagraphs (C) and (D) are limited to such activities as they relate to the activities enumerated in subparagraphs (A) and (B).

the separately identifiable department or division of the bank, as defined in rule G-1).[46]

Family members are not specifically included within the definition of municipal finance professional. The proposal, however, prohibits a dealer and any municipal finance professional from doing any act indirectly which would result in a violation of the proposed rule if done directly by the dealer or municipal finance professional. This is intended to prevent dealers from funnelling funds or payments through other persons or entities to circumvent the proposal's requirements. For example, a dealer would violate the proposal if it does business with an issuer after contributions were made to an issuer official from or by associated persons, family members of associated persons, consultants, lobbyist, attorneys, other dealer affiliates, their employees or PACs, or other persons of entities as a means to circumvent the rule. A dealer also would violate the rule by doing business with an issuer after providing money to any person or entity when the dealer knows that the money will be given to an official of an issuer who could not receive the contribution directly from the dealer without triggering the rule's prohibition on business.

The proposal will not restrict personal volunteer work by municipal finance professionals in political campaigns other than soliciting or coordinating contributions. However,

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[46] The proposal's prohibition on business would result if a municipal finance professional associated with the dealer made the contribution before becoming associated with the dealer, (the two year ban on business applies to both the current and prior employees of the municipal finance professional).

if resources of the dealer are used or expenses are incurred by the municipal finance professional in personal volunteer work, the value of the resources or expenses must be included in determining whether the dealer is restricted from future negotiated underwritings involving that issuer or whether the municipal finance professional exceeded the $250 limitation.

2. Solicitation Restriction. The proposal also will prohibit dealers from soliciting contributions on behalf of officials of issuers with which the dealer is engaging or seeking to engage in municipal securities business.[47] This will prevent dealers from engaging in municipal securities business with issuers if they engage in any kind of fund-raising activities for officials of the issuers that may influence the underwriter selection process. This prohibition on solicitation and coordination also applies to municipal finance professionals. The proposal prohibits municipal finance professionals from soliciting contributions to an official of an issuer with which the dealer engages or is seeking to engage in municipal securities business and from coordinating contributions.

B. Disclosure and Recordkeeping

The proposal would establish disclosure and recordkeeping requirements to facilitate enforcement of rule G-37's "pay to play" restrictions and, independently, to function as a public disclosure mechanism to enhance the

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[47] The term "seeking to engage in municipal securities business" means dealer activities including responding to requests for proposal, making presentations of public finance capabilities, and other soliciting of business with issuer officials.

integrity of and public confidence in municipal securities underwriting. Thus, although the disclosure and recordkeeping provisions will generally supplement the "pay to play" restrictions, the purposes served by these provisions are distinct from, and not dependent on, the business disqualification or solicitation restriction provisions.

1. Rule G-37. Proposed rule G-37 will require dealers to disclose to the MSRB on Form G-37 certain information abut political contributions, as well as other summary information, to facilitate public scrutiny of political contributions in the context of the municipal securities business of a dealer. Contributions to be reported include those to officials of issuers and political parties of states and political subdivisions made by the dealer, any municipal finance professional any executive officer and any PAC controlled by the dealer or by any municipal financial professional.[48] Only contributions over $250 by municipal finance professionals and executive officers are required to be disclosed. The proposal does not require dealers to disclose the names of individual municipal finance professionals and executive officer.

The proposal requires that dealers report on Form G-37 by state: (1) the name and title, (including any city/county/state or other political subdivision) of each official of an issuer and political party receiving contributions; (2) the

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[48] The proposal does not require dealers to maintain a list of contributions by other employees, affiliated companies and their employees, spouses of municipal finance professionals, or any other person or entity unless the contributions were directed by persons or entities subject to the proposal.

total number and dollar amount of contributions made by the dealer, dealer controlled PACs, and associated municipal finance professionals, and (3) other identifying information as required by Form G-37. Dealers also will be required to disclose issuers with which the dealer has engaged in municipal securities business during the reporting period, along with the type of municipal securities business and the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business from the issuers. The reports are required to be made on Form G-37 and to be submitted to the MSRB in accordance with rule G-37 filing procedures, quarterly, by dates determined by the MSRB.

The MSRB will include information reported on Form G-37 in its electronic library system, the Municipal Securities Information Library (MSIL). The MSRB will develop appropriate filing procedures to allow for public access to the information, as well as indexing, and record storage.

2. Rules G-8 and G-9. The proposal will amend rules G-8 and G-9 on recordkeeping and record retention regarding political contributions. The proposed amendment to rule G-8 will require a dealer to maintain a list of: (1) names, titles, city/county and state of residence of all associated municipal finance professionals; (2) names, titles, city/county and state of residence of all executive officers of the dealer; (3) the states in which the dealer is engaging or is seeking to engage in municipal securities business; (4) every issuer with which municipal securities business has been conducted during the current year, as well as the previous two years and, where applicable, the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with the issuer; and (5)

all contributions, direct or indirect, to officials of issuers and to political parties of states and political subdivisions made by the dealer, each dealer-controlled PAC, and each associated municipal finance professional and executive officer.[49] The records required pursuant to the proposal apply to contributions made or business engaged in beginning [insert date 10 days after publication in the Federal Register].[50]

The proposal does not require the dealer to maintain a last of contributions by its municipal finance professionals or executive officers that are made: (1) to officials for whom the person is entitled to vote, provided such contributions do not exceed $250 to each issuer official, per election; or (2) to political parties for the state and political subdivision in which the person is entitled to vote, provided the contributions do not exceed $250 per party, per year. The proposal also does not require dealers to maintain a list of contributions by any other employees, affiliate companies and their employees, spouses of covered employees, or any other person or entity unless the contributions were directed by persons or entities subject to proposed rule G-37.

The proposed amendment to rule G-9 requires dealers to maintain, for a six-year period, those records required to be made pursuant to the proposed amendment to rule G-8.

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[49] Dealers will be required to record, per contribution, the identity of the contributor and the recipient and the amount of the contribution.

[50] File No. SR-MSRB-94-2, Amendment No. 1 (March 29, 1994). See supra note 4.

IV. Summary of Comments

The Commission received 69 comment letters on the proposal. A separate summary of comments was prepared and is available in the public file. The Discussion section of this order addresses specific issues addressed by the commentators.

V. Discussion

The MSRB's rule proposal seeks to end "pay to play" abuses in municipal securities underwritings. The MSRB has determined that the most effective means of accomplishing this goal is through adoption of several provisions consisting, as described above, of a business disqualification provision, a solicitation restriction and disclosure and recordkeeping requirements. These provisions reflect well-established methods for dealing with conflicts of interest and other instances where improper influence is used to secure an unmerited benefit.

The Commission believes that the MSRB's proposal is tailored to accomplish its stated goals with minimal disruption in the municipal securities industry and the state and local political process to which that industry is linked. The commission agrees with the MSRB that its proposal represents an appropriate response to a compelling problem and, therefore, has determined to approve the proposed rule change.

A. Statutory Standard

The proposed rule change is consistent with the requirements of the Act, and in particular, with Sections

158(b) (2) (C) and (G) of the Act.[51] Section 158(b) (2) (C) authorizes the MSRB to adopt rules designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and, in general, to protect investors and the public interest. Section 158(b) (2)16) authorizes the MSRB to adopt rules that prescribe the records to be made and kept by municipal securities dealers and the periods for which such records shall be preserved. Because the MSRB's rules are to be preventive in nature, Section 15B defines the scope of the MSRB's authority in terms of purposes rather than subject matters. This authority provides the MSRB with flexibility to deal with future problems in the municipal securities industry.[52] Thus, Section 15B provides the MSRB

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51 Sections 15B(b)(2)(C), (G); [15 U.S.C. §§ 78o-4(b)(2)(C), (G)].

52 The legislative history of the 1975 Acts Amendments adopting Section 15B indicated that Congress did not believe it would be desirable to restrict the MSRB's authority by a specific enumeration of subject matters. "The ingenuity of the financial community and the impossibility of anticipating all future circumstances are obvious reasons for allowing the [MSRB] a measure of flexibility in laying down the rules of the municipal securities industry." S. Rep. No. 75, Securities Exchange Act of 1975: Report of the Committee on Banking, Housing, and Urban Affairs, to Accompany S. 249, 94 Cong., 2d Sess. 43 ("Senate Report") at 225.

broad rulemaking authority to implement its enumerated purposes.

1. Prevent Fraudulent and Manipulative Acts and Practices. The Commission and the MSRB have a significant interest in preventing fraudulent and manipulative acts and practices, as well as the appearance of fraud and manipulation, in the municipal securities market. One of the principal goals of Section 15B is to address threats to the integrity of the municipal securities market.[53] Underwriters perform essential functions in offerings by structuring the offering and preparing disclosure documents that form the basis of marketing the offering to the public.[54] If underwriter selection is swayed by political contributions or

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53 "S. 249 would provide, through amendment of the Exchange Act, a comprehensive pattern for the regulation of brokers, dealers, and banks trading municipal securities. The Committee feels that the lack of federal regulation . . . represents a serious threat to the integrity of the capital-raising system upon which local governments rely to finance their efforts." Senate Report at 215, 16.

54 In the proposing and adopting releases for Rule 15c2-12, the Commission set forth its interpretation of the obligation of municipal securities underwriters under the antifraud provisions of the federal securities laws. The interpretation discussed the duty of underwriters to the investing public to have a reasonable basis for recommending any municipal securities, and their responsibility, in fulfilling that obligation, to review in a professional manner the accuracy of statements made in connection with the offering. Securities Exchange Act Release No. 26100 (September 28, 1988), 53 FR 37778; Securities Exchange Act Release No. 26985 (July 10, 1989), 54 FR 28799.

influence, underwriters may be chosen based on their history of contributions or political contacts, rather than their expertise or competence.

Several commentators contend that reports of abuse are unsubstantiated,[55] or view the issue as one of voter confidence and campaign reform, rather than investor

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55 For example, one commentator states that "there have been relatively few reported instances of improper behavior in the market where approximately 15,000 issues are sold each year involving thousands of public officials.... Many of the high-profile cases of improper behavior that have been cited as evidence of corrupt practices caused by campaign giving are either illegal already or would not be affected by a prohibition on political contributions." Letter from Jeffrey I. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994). See also letter from Donald J. Borut, Executive Director, National League of Cities, to Jonathan Katz, Secretary, Commission (February 7, 1994); letter from Harlan E. Boyles, State Treasurer, North Carolina, to Arthur Levitt, Chairman, Commission (January 28, 1994).

Several commentators state that the majority of political contributions by municipal securities dealers and their associated persons are given for legitimate purposes and are unrelated to the selection of municipal securities underwriters. E.g., letter from Jeffrey I. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994).

protection.[56] The Commission believes, however that "pay to play" practices may damage the municipal securities market in several ways. If political influence is the determinative factor in the choice of municipal securities dealers as underwriters in an offering, the underwriter selected may be less likely or competent to perform a reasonable investigation of statements made by the issuer in connection with the offering.[57] A decrease in the credit quality of the issue after it has been sold could have a significant adverse impact on investors, and the underwriter's investigation might reveal information that bears directly on the issuer's future ability to meet interest and principal payment obligations on a timely basis.

"Pay to play" also undermines the integrity of municipal securities underwriting. The mere perception of political influence in underwriter selection diminishes investor confidence in an underwriter's willingness to faithfully fulfill its obligations to the investing public. The Statement of Initiative itself attests to the prevalence of industry concerns regarding the effects of these practices on the integrity of the municipal securities market and underwriters.

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56 E.g., letter from Jeffrey I. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission, (March 10, 1994). The Government Finance Officers Association "believes that any improper relationship is properly a voter, taxpayer and ratepayer concern because of the potential impact such a relationship could have on the cost of the financing."

57 See supra note 54.

The perception of conflicts of interest is also damaging to investor confidence. Although some commentators suggest that investor confidence has not been affected by "pay to play" practices,[58] the Commission, relying on its own expertise as well as the judgment of the MSRB, believes that the widespread reports of abuse adversely affect investor confidence and that the MSRB's proposal will help to strengthen the integrity of the underwriting process and will help to restore and maintain investor confidence.[59]

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[58] One commentator states that "[t]o my knowledge the practice of campaign contributions made by participants of the municipal securities industry has not resulted in bond defaults or other value losses that directly affect individual investors. Even the most egregious abuses documented in the national press have not resulted in investor losses in either primary offerings or in the secondary markets." Letter from Kenneth L. Rust, Debt Manager, Mayor, City of Portland, Oregon, to Jonathan Katz, Secretary, Commission (February 28, 1994)

[59] Because, as discussed herein, regulation of political contributions by municipal securities dealers and municipal securities professionals is intended to enhance the fairness and efficiency of the municipal securities market, it is directly related to the purposes of the Act. Some commentators raise objections to the proposal on federalism grounds. E.g., letter from David Norcross, General Counsel, Republican National Committee to Jonathan Katz, Secretary, Commission (March 11, 1994). Although the MSRB's proposal will have some effect on political fundraising activities of candidates for certain state

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2. Perfect the Mechanism of Free and Open Market. As discussed above, several reports have indicated that "pay to play" practices are considered by many municipal securities underwriters to be an ordinary cost of doing business. Because of great competitive pressures to obtain business, municipal securities firms and the offering process are susceptible to abusive political contribution practices. "Pay to play" practices raise artificial barriers to competition for those firms that either cannot afford or decide not to make political contributions. Moreover, if "pay to play" is the determining factor in the selection of an underwriting syndicate, an official may not necessarily hire the most qualified underwriter for the issue. The proposal makes clear to municipal securities dealers and to officials of issuers that "pay to play" practices should no longer be employed to obtain municipal securities business. The proposal will further merit-based competition between municipal securities dealers and, thus, will remove impediments to and perfect the mechanism of a free and open market for municipal securities.

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[59](...continued)

and local offices, these effects do not transgress any limits on federal authority over state political activities. The MSRB's rules are directed at municipal securities dealers and municipal finance professionals and do not regulate the conduct of state officials. Cf. New York v. United States, 112 S. Ct. 2408 (1992). As such, the proposed rule change falls within the legitimate scope of the MSRB's congressionally-mandated jurisdiction regarding the conduct of municipal securities participants, notwithstanding any incidental effects on state elections.

3. Promote Just and Equitable Principles of Trade. The proposal will promote just and equitable principles of trade. One of the primary principles of Section 15B is to raise the level of conduct in the municipal securities industry.[60] "Pay to play" practices undermine these principles since underwriters working on a particular issuance may be assigned similar roles, and take on equivalent risks, but be given different allocations of bonds to sell—resulting in differing profits—based on their political contributions or contacts. The MSRB, under the Commission's supervision, was given primary rulemaking authority to regulate the conduct of municipal securities dealers by adopting rules to promote just and equitable principals of trade. In particular, the MSRB is obligated to assure that municipal securities dealers observe high professional standards in their activities with the public. The Statement of Initiative demonstrates the significance with which municipal securities dealers address reports of abuse in the municipal securities market. The proposal will extend the goals of the Statement of Initiative to all municipal securities dealers attempting to obtain municipal securities business.

4. Foster Cooperation and Coordination in Regulating Municipal Securities Transactions. The proposal will foster cooperation and coordination with persons engaged in regulating transactions in municipal securities. The proposal's disclosure and recordkeeping requirements will aid the Commission, the MSRB, and the NASD to oversee enforcement of and dealer compliance with the proposal.

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[60] See Senate Report at 224, 25. Because the MSRB is an SRO for municipal securities dealers, it is an appropriate body to establish just and equitable principles of trade.

5. Records and Record Retention. The proposal's record and record retention requirements are consistent with Section 158(b) (2) (G) of the Act which authorizes the MSRB to adopt rules that prescribe the records to be made and kept by municipal securities dealers and the periods for which such records shall be preserved. As discussed above, the proposal's record and record retention requirements, along with its prohibitions on municipal securities business, are designed to prevent "pay to play" practices in the awarding of municipal securities business.

B. First Amendment Guarantee of Free Speech

Several commentators believe that the proposal's prohibitions on political contributions impermissibly infringe on the First Amendment guarantees of freedom of speech and association,[61] and constitutional guarantees of equal

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[61] One commentator, for example, states that "it is an infringement on individual first amendment rights to prohibit any person's financial support of a candidate because it is 'presumed' the contributor is involved in some 'pay to play' scheme." Letter from Michael E. Arrington, Chairman, Bi-County Sub-Committee, Maryland House of Delegates, to Arthur Levitt, Chairman, Commission (December 22, 1993). See e.g. letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994); letter from Marshall Bennett, President, and Bob Holden, Ethics Task Force, National Association of State Treasurers, to Jonathan Katz, Secretary, Commission (March 11, 1994); letter from David Norcross, General Counsel, Republican National Committee to Jonathan Katz, Secretary, Commission (continued...)

protection.[62] These commentators believe that although municipal bond business should not be a "pay back" for political contributions, the proposal restricts the ability of municipal securities underwriters and their employees to demonstrate support for state and local officials.[63]

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[61](...continued)
(March 11, 1994).

[62] One commentator, for example, states that "Rule G-37 fails to treat similarly-situated individuals in a like manner by classifying municipal broker-dealers and municipal finance professionals as the only persons subject to the burdens of the rule while other similarly situated persons, such as consultants and non-registered municipal finance professionals, are not subject to the same burden." Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

[63] See e.g., letter from Donald J. Borut, Executive Director, National League of Cities, to Jonathan Katz, Secretary, Commission (February 7, 1994); letter from Michael E. Arrington, Chairman, Bi-County Sub-Committee, Maryland House of Delegates, to Arthur Levitt, Chairman, Commission (December 22, 1993); letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

In light of the Commission's approval and enforcement of MSRB's rules, the Commission is sensitive to and has carefully considered these constitutional concerns in reviewing the proposed rule change.[64] The Commission acknowledges that the business disqualification provision may affect the propensity of municipal securities underwriters to make political contributions. Although political contributions involve both speech and associational rights protected by the First Amendment, a "limitation on the amount that any one person or group may contribute to a candidate or political committee entails only a marginal restriction upon the contributor's ability to engage in free communication." [65] Even a significant interference with rights protected by the First Amendment may be justified by a sufficiently compelling government interest so long as the interference is closely drawn to avoid unnecessary abridgment of thou protected rights.[66]

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[64] Several commentators disagree with the MSRB's conclusion that it is not a state actor for purposes of constitutional protections. See letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994); letter from Marshall Bennett, President, and Bob Holden, Ethics Task Force, National Association of State Treasurers, to Jonathan Katz, Secretary, Commission (March 11, 1994); letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

[65] Buckley v. Valeo, 424 U.S. 1, 20 (1976).

[66] Id. at 25.

Prevention of fraud and manipulation and the appearance of fraud and manipulation are compelling government interests. The MSRB's proposal is in the context of a closely regulated industry and is directly relevant to the concerns of the regulatory scheme. The MSRB's interests in seeking approval of the proposed rule change—the eradication of "pay to play" practices and other arrangements—are precisely the kind of interests which have been deemed sufficiently compelling to justify restrictions on political contributions.[67] As discussed above, "pay to play" arrangements can have detrimental effects on the municipal securities markets; the widespread perception that these practices are commonplace undermines the integrity of the market and diminishes investor confidence. Moreover, the restrictions inherent in the MSRB's proposed rule change are in the nature of conflict of interest limitations which are

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[67] For example, Florida's Division of Bond Finance prohibits the awarding of municipal securities business to firms that make political contributions to the governor or to cabinet members. Florida State Board of Administration, Rule 19A-6.004. Florida also prohibits investment and law firms and their officers, directors, and employees that make contributions or engage in fundraising for state-level candidates from competing for business from the Florida Housing Finance Agency. Rules of the Florida Housing Finance Authority (1991). Several states prohibit contributions from corporations and regulated industries in state elections including Arizona, Ariz. Rev. Stat. Ann. § 16-919; Connecticut, Conn. Gen. Stat. Ann. § 9-333o(a); North Dakota, N.D. Cent. Code §§ 16.1-08-02(l), 16.1-08-01 (10); Pennsylvania, Penn. Stat. Ann. tit. 25, § 3253; South Dakota, S.D. Codified Laws Ann. § 12-25-2; West Virginia, W. Va. Code § 3-8-8; Wisconsin, Wis. Stat. Ann. § 11.38; and Wyoming, Wyo. Stat. § 22-25-102.

particularly appropriate in cases of government contracting and highly regulated industries. Unlike general campaign financing restrictions, such as certain provisions of the Federal Election Campaign Act, which seek to combat unspecified forms of undue influence and political corruption, conflict of interest provisions, such as the MSRB's proposal, are tied to a contributor's business relationship with governmental entities and are intended to prevent fraud and manipulation.[68]

As previously noted, the Commission believes that the MSRB's proposed rule change is closely tailored to accomplish its goal of preventing fraudulent and manipulative acts and practices that stem from quid pro quo arrangements and minimizes any undue burdens on the protected speech

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[68] Compare 2 U.S.C. §§ 441 (a), (b) (general contribution restrictions in federal campaigns applicable to individuals, corporations and labor unions) with 2 U.SC. §441(c) (prohibition on contributions by federal contractors). Similarly, the prohibitions on solicitation and coordination of campaign contributions are justified by the same overriding purposes which support the business disqualification provisions. The provisions are intended to prevent circumvention of the disqualification provisions in cases where a dealer has or is seeking to establish a business relationship with a municipal issuer. Absent these restrictions, solicitation and coordination of contributions could be used as effectively as political contributions to distort the underwriter selection process. The solicitation and coordination restriction relate only to fundraising activities and would not prevent dealers and municipal finance professionals from expressing support for candidates in other ways.

and associational rights of municipal securities dealers and municipal finance professionals. The proposed rule change is narrowly crafted in terms of the conduct it prohibits, the persons who are subject to the restriction, and the circumstances in which it is triggered.

The proposal is limited to contributions to officials of municipal issuers who can influence the hiring of a dealer in connection with negotiated offerings. The restrictions are triggered only in situations where a business relationship exists or will be established in the near future between the municipal securities dealer and a municipal issuer. Most employees and affiliates of dealers are not covered by the proposal, and the dealer's municipal finance professionals will be able to avail themselves of a personal contribution exception of up to $250, individually, with respect to officials for whom they are eligible to vote. The proposal does not restrict uncoordinated independent expenditures in support of candidates or political views. Moreover, because the contribution limitations take the form of a business disqualification, the proposal does not flatly prohibit individuals from making, or prevent candidates from receiving contributions. In addition, the proposal does not, as some commentators suggest, restrict the ability of municipal securities underwriters and their employees to demonstrate support for state and local officials. Underwriters and their employees may continue to contribute in other ways in political campaigns that do not involve soliciting or coordinating contributions.[69]

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[69] A number of states separately limit individual contributions in state elections including, for example: Arizona $640 per state wide candidate, $250 per other offices, and a (continued...)

The Commission believes that the proposed rule change is a necessary and appropriate measure to prevent fraudulent and manipulative acts and practices and the appearance of fraud and manipulation in the municipal securities market by eliminating "pay to play" arranged underwritings. The proposal represents a balanced response to allegations of corruption in the municipal securities market; it provides specific prohibitions to help ensure that underwriter selection is based on expertise, not on the amount of money given to a particular candidate for office.

C. Municipal Securities Dealers: Small Firms and Minority and Women Owned Firms

Several commentators believe that the proposal will disadvantage small, regional municipal securities firms and firms owned by minorities or women.[70] Because larger firms

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[69](...continued)
maximum of $2,000 in total contribution per calendar year, Ariz. Rev. Stat. Ann. § 16-905; Florida, $500 per candidate, Flor. Stat. Ann. 106.08; and Montana, $1,500 collectively to candidates for governor and lieutenant governor, $750 to candidates for state office in a statewide election, $400 to candidates for public service commissioner, district court judge, or state senator, $250 to a candidate for any other public office, Mont. Code Ann. §§ 13-1-101, 13-37-216.

[70] See e.g., letter from Timothy L. Firestine, Director of Finance, Montgomery County Government, to Jonathan Katz, Secretary, Commission (February 24, 1994); letter from Stan W. Helgerson, Finance Director, Village of Carol Stream, Illinois, to Jonathan Katz, Secretary, (continued...)

may have more employees that may be eligible to use the de minimis exemption, these commentators believe that the proposal will provide larger firms an unfair advantage.[71]

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[70](...continued)

Commission (March 10, 1994); letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994); letter from Caroline R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

[71] One commentator, for example, states that "larger firms with - multiple departments including those not devoted to public finance will be able to support candidates through contributions made by corporate or other specialists who are not affected by this rule. Minority- and women-owned firms typically are small specialty public finance firms so their employees would be barred from supporting candidates." Letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994).

Another commentator recommends that the proposal should extend the de minimis exemption to officials for whom the municipal securities finance professionals are not entitled to vote to allow "continuing access to clients and [enable] us to exercise our constitutional and political rights." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994). Another commentator recommends that the proposal exclude small issues (e.g., $10,000,000 par value or less) to lessen the impact of the rule on small regional, minority-owned, and women-owned

(continued...)

The Commission believes that the proposal will not have a disproportionate effect on minority or women-owned firms or on small and regional firms. The proposal clearly does not prevent local and state officials from selecting minority or women-owned municipal securities dealers for participation in municipal securities issuances.[72] Moreover, the proposal will apply equally to all municipal securities dealers seeking to obtain municipal securities underwriting business. The Commission is not aware of any evidence indicating that the proposed rule change will disproportionately affect minority or women-owned firms, or smaller and regional firms vis-a-vis large dealers. The Commission rejects the notion that campaign contributions are a unique and essential business development mechanism for small, regional, or minority and women-owned firms. As a practical matter, the proposal leaves open all legitimate marketing practices which firms, both large and small, may use to gain underwriting business such as sales presentations, seminars, and marketing documents. Moreover, the Commission believes that the costs of incidental, unintended

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[71](...continued)

firms. Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

[72] The Commission believes that promoting minority and women-owned firms is a valid goal. Other means exist to promote this goal. For example, the Commission understands that some issuers require the underwriting-syndicate to include one or more minority or women-owned firms.

effects, if any, are far outweighed by the benefits of restricting "pay to play" practices.

D. Effect on Women and Minority Candidates

Some commentators suggest that the proposal will adversely affect women and minority candidates for state and local office, or will inhibit the ability of municipal securities professionals to volunteer for public service.[73] The basis for this contention is uncertain, but the proposal is clearly not intended to affect any particular candidate or identifiable group of candidates in an adverse manner. As noted before, the restrictions relate only to those situations where contributions are directed to an official of a municipal issuer with which a dealer might do business. It does not prevent other forms of indirect financial support for a candidate, such as contributions to political action committees that are not controlled by the dealer or its municipal finance professionals, or independent expenditures.[74]

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[73] "Many such candidates either lack substantial personal resources and/or live in districts with limited resources.It is essential, therefor, that such candidates be able to solicit broad support from outside sources." Letter from Marshall Bennett, President, and Bob Holden, Ethics Task Force, National Association of State Treasurers, to Jonathan Katz, Secretary, Commission (March 11, 1994).

[74] The proposal will not prevent contributions to "special-interest" PACs that are not controlled by the dealer or municipal finance professional unless the special interest PAC solicits contributions for the purpose of supporting an identifiable candidate. Thus, the proposal will have no (continued...)

E. Candidates for Federal Office

Several commentators also suggest that the proposal should apply to contributions made to officials of or candidates for federal office.[75] Several commentators raise

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[74](...continued)
effect on the ability of market participants to support candidates who represent their ideological, political, or social interests, or on the ability to volunteer for public service, notwithstanding concerns expressed by some commentators to the contrary. Letter from Robin L. Wiessmann, Principal, Artemis Capital Group, Inc., to Arthur Levitt, Chairman, Commission (December 21, 1993).

[75] E.g. letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994). One commentator objected to the proposal on the grounds that, with respect to municipal officials who are candidates for federal office, the MSRB's authority to adopt rules, subject to Commission approval, regulating campaign contributions of dealers and their employees conflicts with the jurisdiction of the Federal Election Commission ("FEC") under the regulatory scheme established in the Federal Election Campaign Act ("FECA"). Letter from David Norcross, General Counsel, Republican National Committee, to Jonathan Katz, Secretary, Commission (March 11, 1994). Although FECA confers exclusive jurisdiction for enforcing the provisions of FECA, the MSRB rules would not affect; directly or indirectly, the provisions of FECA or their enforcement. Rather, as discussed above, the MSRB's proposal is specifically tailored to eliminate conflicts of interest arising from
(continued...)

concerns that the proposal will restrict contributions to state and local officials running for federal office, without a similar limitation on contributions to the incumbent federal office holder.[76]

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[75](...continued)

political contributions and similar activities in selecting underwriters in connection with negotiated offerings of municipal securities.

[76] One comment letter, representing state and local officials, states:

> While our organizations recognize the importance of maintaining the integrity of the municipal bond market, we are greatly concerned that the proposed rule is inherently unfair in its limited application to only state and local officials. We fail to understand why this proposed action by the Securities and Exchange Commission is not coupled with a comprehensive limitation on contributions to the federal branch of government, which has perhaps the greatest influence over the strength of the municipal bond market and investor confidence in that market.

Letter from Jerry Abramson, President, The United States Conference of Mayors, Sharpe James, President, The National League of Cities, Barbara Sheen Todd, President, The National Association of Counties, and Bonnie R. Kraft, President-Elect, the Government Finance Officers Association, to Arthur Levitt, Chairman Commission (February 18, 1994).

The Commission believes that it is not necessary to extend the proposal to include contributions to candidates for federal office. The proposal addresses abusive political contributions to officials of issuers who may influence the selection of municipal securities underwriters. Because federal office holders do not influence the underwriter selection process, the Commission believes that it would not be appropriate to include federal candidates under the rule's requirements.

By the same token, the Commission also believes that any resulting hardship to candidates for federal office who are currently local officials is not a reason for eliminating these requirements. The MSRB cannot overlook potential conflicts of interest solely because there are candidates for the same federal office who do not face the same conflicts. In any event, the resulting burden to current local officials does not appear to be significant. Generally, municipal underwriters play a less significant role as contributors in federal elections. Moreover, under federal law there exist general contribution restrictions that limit the amount of contributions that other candidates are able to obtain from municipal securities dealers and municipal finance professionals.[77]

F. Municipal Securities Dealer Affiliates

Several commentators believe that the proposal should apply to contributions from all employees affiliated with the underwriter and from affiliated financial institutions and their

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[77] See supra note 68.

employees.[78] Several commentators specifically express concern that the proposal excludes contributions by chief executive officers of banks,[79] or by PACs controlled by banks or bank holding companies, which have a municipal securities dealer department or subsidiary.[80] These

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78 One commentator, for example, believes that the "rule is ineffective because it does not cover all related personnel who can continue to contribute to officials of issuers thereby creating the actual or apparent conflict of interest which the MSRB rule seeks to prevent." Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

79 One commentator, for example, states that "[w]e strenuously object to a narrowly-based requirement that diminishes the ability of our Chief Executive and members of our executive committees to participate as community leaders, to engage in political dialogue and to develop our firm's profile in the communities in which we do business to the same extent as local bank chief executives" Letter from William H. Ellis, President and Chief 'Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

80 One commentator, for example, states that "[c]ommercial banks would be free to continue making PAC contributions to local and state level political candidates and in the process gain a significant competitive advantage in the selection process for public finance undertakings. Those candidates receiving bank PAC contributions would (continued...)

commentators believe that by exempting affiliated banks and bank holding companies, the proposal provides a "loophole" for continued abuse of political contributions by municipal securities dealers and their affiliates.[81]

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[80](...continued)

certainly remember such support when bank dealer personnel are introduced or accompanied by commercial bankers in the selection process. It is a typical procedure for the local bank officer to lobby and/or speak in behalf of the hiring of his public finance entity." Letter from Clifford A. Lanier, Jr., The Frazer Lanier Company, to David C. Clapp, Chairman, MSRB (March 1, 1994).

Another commentator states that "[i]t is unreasonable to believe that political candidates, including 'issuer officials,' will be able or need to, discern between contributions from a bank-controlled PAC and a bank's municipal securities 'dealer-controlled' PAC. This appears to us to represent 'business as usual' for bank-controlled municipal dealers while we are both stigmatized and potentially disadvantaged competitively." Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

[81] "Unfortunately, the proposed rule as written is so severely deficient in ignoring the sophisticated realities of political fundraising undertaken by securities firms, that the loopholes and fine distinctions posed promise to provide a road map for more sinister activities, possibly making the situation worse." Letter from Mark D. Schwartz, to Arthur Levitt, Chairman, Commission (January 31, 1994). Several commentators question the ability of the MSRB or the NASD to enforce Rule G-37. For example, one

(continued...)

The Commission believes that the MSRB's proposed rule change is not deficient merely because it does not include affiliated banks and bank holding companies. Because of the sensitivity to constitutional and other concerns, the Commission believes that the coverage of the proposal is no broader than is necessary to effectuate its purpose and that extending the scope to cover affiliated banks and bank holding companies is not necessary.[82]

G. De Minimis Exemption

Several commentators recommend that the proposal increase the de minimis amount that municipal finance

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[81](...continued)
commentator believes that "[p]olitical favors will go to those investment banks that flaunt or circumvent the rule while those firms who live by the rules will suffer accordingly." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

[82] The Commission will monitor closely the implementation of the proposal and its effects on the market, and if it determines that abusive practices continue to exist, will encourage the MSRB to expand the scope of the rule. In response to the suggestion that financial advisers be required to register as municipal securities broker-dealers and be subject to the proposal, the Commission notes that such a recommendation is beyond the scope of this proposal. See e.g. letter from Vivian Altman, Altman & Co., to Jonathan Katz, Secretary, Commission (January 31, 1994).

professionals may contribute.[83] Several commentators recommend that the rule should provide a "good faith" exemption for inadvertent violations.[84] One commentator

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[83] These commentators express concern that inadvertent violations by municipal securities dealers or associated persons covered by the rule may prevent dealers from participating in an underwriting, and, thus, raise the cost of a municipal securities issuance. For example, one commentator states that "we are concerned that your rule could deprive a state or local government of the opportunity to work with a company which may be offering the most desirable rates simply due to a technical infraction." Letter from Jerry Abramson, President, The United States Conference of Mayors, Sharpe James, President, The National League of Cities, Barbara Sheen Todd, President, The National Association of Counties, and Bonnie R. Kraft, President-Elect, the Government Finance Officers Association, to Arthur Levitt, Chairman, Commission (February 18, 1994).

[84] For example, one commentator states that "[c]learly, the tradition of broker-dealer regulation in the U.S. is based upon the requirement that securities firms have adequate policies and procedures in place to assure compliance with laws and regulations not that each broker-dealer be a guarantor of perfect compliance." Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994). Another commentator believes that the proposal, "consistent with many other rules and regulations applicable to the securities industry, may achieve its purposes but temper its remedy for firms with adequate compliance procedures and supervision." Letter from D. Kelly, A.G. Edwards & Sons, Inc., to Jonathan Katz, (continued...)

recommends that the rule provide a "safe harbor" provision for certain contributions.[85] Another commentator believes that the proposal should exempt contributions made for legitimate purposes.[86]

Several commentators believe that the de minimis exemption should be expanded to include contributions to officials for whom the municipal finance professionals are not

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[84](...continued)

Secretary, Commission (March 10, 1994). See also letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officers, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994); letter from George B. Pugh, Jr., Chairman, Municipal Securities Division, Public Securities Association, to Jonathan Katz, Secretary, Commission (March 11, 1994).

[85] For example charitable contributions, contributions to non-partisan associations in which elected officials may be members or participants, support of ballot propositions, certain services in the normal course of business, contributions by spouses or household members, contributions to national political parties, contributions to state and local political parties and certain contributions to political action committees. Letter from D. Kelly, A.G. Edwards & Cons, Inc., to Jonathan Katz, Secretary Commission (March 10, 1994).

[86] Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland; Deputy Secretary, Commission (March 9, 1994).

entitled to vote.[87] These commentators believe that the proposal prevents municipal securities dealers from establishing business relationships with issuers,[88] and from supporting candidates with similar views important to the municipal finance professional or to the municipal securities broker-dealer firm.[89] One commentator recommends that the

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[87] For example, one commentator believes that " [d]ealers should not be prohibited from making contributions to persons for whom they are unable to vote. They should have a right to support the candidates of their choice." Letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary Commission (March 10, 1994).

[88] Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary Commission (March 9, 1994).

[89] For example, one commentator believes that "[t]he provision limiting contributions to one's voting jurisdiction denies municipal securities professionals access to politicians who influence their corporate and individual political interests. Specifically, municipal securities professionals will be denied the ability to support politicians who champion their personal beliefs or corporate concerns. For example, a firm headquartered in New York City whose president and employees •live on Long Island would be unable to send a representative to a dinner for the mayor of New York City or for the mayor's political opponent. Yet the mayor's decisions on issues such as zoning, corporate taxes, and transportation policy significantly impact the company's viability." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

proposal allow contributions to candidates that represent the area in which the professionals' principal office is located.[90]

The Commission believes that the MSRB's determinations as to the amount of the de minimis exemption and limiting its application to contributions to officials for whom the municipal finance professional is entitled to vote are appropriate and reasonable. As discussed, the proposal provides specific guidelines to prevent "pay to play" contributions. The proposal provides an appropriate balance between limiting "pay to play" practices and the ability of dealers and their employees to demonstrate support for state and local candidates. The proposal recognizes that certain contributions made for legitimate political purposes present less risk of a conflict of interest or the appearance of a conflict of interest. Although an individual may have a legitimate interest in making contributions to candidates for whom she is ineligible to vote, there is a greater risk in such circumstances that the contribution is motivated by an improper attempt to influence municipal officials. Thus, the proposal enables municipal finance professionals to contribute $250 per election to candidates for whom they are entitled to vote without triggering the proposal's business limitation. As discussed, the proposal does not prevent dealers or their employees from demonstrating support for local and state officials in other ways including volunteer political campaign activity.

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[90] Letter from Gerald E. Pelzer, President, Clayton Brown & Associates, Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

H. General Provisions

Several commentators believe that the proposal is operationally too burdensome to implement. These commentators believe that because of the number and types of persons subject to the rule's prohibitions, it will be difficult for municipal securities dealers to implement and enforce compliance procedures.[91] Some commentators

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91 For example, Piper Jaffray Inc. expresses concern regarding the ability of broker-dealer firms to screen newly hired employees or current employees seeking employment with the firm's municipal securities departments, and the ability to hire civil servants. Piper Jaffray Inc. believes that "[t]his would require firms to screen all applicants for these jobs by requiring them to declare to whom they made political contributions and make judgmental evaluations as to whether their earlier campaign activities would be potentially violative of the rule and not offer a job to any offending contributor." Piper Jaffray Inc. believes that this will almost certainly expose broker-dealer firms to the risk of civil litigation. Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

Another commentator states that "a person who has made a contribution within the past two years apparently taints a firm which hires the individual even if the individual was not involved in the municipal securities business at the time of the contribution. Two serious problems exist. The first is that even a firm with strict reviews for hiring may find itself barred.... The second is that many active citizens will find themselves de facto barred from entering the public finance, banking and brokerage businesses." Letter from D.

(continued...)

believe that the proposal's disclosure and recordkeeping requirements are overly burdensome.[92] Several commentators also believe that the scope of the proposal is uncertain and recommend that it provide more complete standards regarding

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[91](...continued)
Kelly, A.G. Edwards & Sons, Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

[92] E.g., letter from A.B. Krongard, Chief Executive Officer, Alex, Brown & Sons, to Jonathan Katz, Secretary, Commission (March 15, 1994); letter from Robert F. Price, Chairman, Federal Regulation Committee, Securities Industry Association, to Jonathan Katz, Secretary, Commission (March 17, 1994). The Securities Industry Association believes that the proposal's reporting provisions should be amended to: (1) require quarterly submissions for only those quarters in which the dealer has any contributions to report; (2) delete the requirement to report lists of issuers with which the dealer conducts municipal securities business; and (3) delete the requirement to disclose the name, company, role, and compensation arrangement of any person employed by the dealer to obtain municipal securities business.

employee contributions,[93] the use of consultants and law firms,[94] bonds issued by corporations with

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93 For example, A.G. Edwards & Sons, Inc. believes that the "provision is ambiguous. Read most broadly the definition of municipal finance professional in proposed Rule G-37 could be construed to include any retail broker who sells. municipal securities.... As a result of the possible ambiguity and the changing application, firms employing retail brokers likely will interpret the provision broadly to avoid being barred from the municipal finance business. The result will be that numerous brokers who have no participation in securing municipal securities business will be barred from political activities." Letter from D. Kelly, A.G. Edwards & Sons, Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

94 E.g., Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994). One commentator recommends the proposal clarify that the definition of municipal finance professional excludes independent law firms or persons retained by a dealer for purposes other than the solicitation of municipal securities business. Letter from Richard H. Martin, Attorney, Leonard, Street and Deinard, to Jonathan Katz, Secretary, Commission (March 8, 1994).

One commentator recommends that the proposal should be clarified to exclude from the definition of municipal finance professional any independent firms or persons retained by a broker-dealer for purposes other than the solicitation of municipal securities business. Letter from Richard H. Martin, Attorney, Leonard, Street and Deinard, to Jonathan Katz, Secretary, Commission (March 8, 1994).

assistance of local governments,[95] the definition of "election,"[96] and the definition of "official of such issuer."[97] One commentator requests that the proposal contain a "sunset" provision to require the MSRB to review rule G-37 after a fixed number of years.[98]

The Commission believes that the proposal's provisions are sufficiently specific to permit compliance with its terms. The Commission also understands that industry efforts are currently underway to draft proposed guidelines to assist dealer compliance with the proposal. In addition, the MSRB will provide continued interpretive guidance to assist

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95 Id.

96 One commentator, for example, states that "[a]n election should be defined and it should be made clear that if a contributor gives for a specified election, the amount shall only be considered as a contribution for the election for which the amount was given even if the candidate has the legal right to carry over amounts to other elections." Letter from D. Kelly, A.G. Edwards & Sons, Inc, to Jonathan Katz, Secretary, Commission (March 10, 1994).

97 "An influence standard leaves the industry uncertain as to whom contributions may be made and, judged retrospectively, may cause inadvertent violations." Id.

98 This "would allow all parties to regularly review G-37 to determine whether G-37 is effective and meeting the goals it was created to achieve and to accommodate any other relevant developments such as campaign finance reform." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

dealer compliance with the proposal. The Commission, in accordance with its statutory mandate, will continue to monitor the implementation of the proposal and the effects the proposal may have on the market.

I. Amendment No. 1

The Commission finds good cause for approving the MSRB's Amendment No. 1, pursuant to Section 19(b) (2) of the Act, prior to the thirtieth day after the date of publication of notice of the amendment. As originally submitted, the proposal's prohibitions on municipal securities business would arise from contributions made on or after April 1, 1994. The MSRB filed the amendment to change the April 1, 1994 date to a date 10 days after publication in the Federal Register of the order approving the proposal. The MSRB also amended the proposal to change the effective date of the proposal's disclosure and recordkeeping requirements to a date 10 days after publication of. the approval order in the Federal Register. Thus the proposal's prohibitions will arise from contributions made on or after [insert date 10 days after publication in the Federal Register]. The proposal's disclosure and recordkeeping requirements also will not be effective until [insert date ten days after publication in the Federal Register]. The Commission believes that the amendments will facilitate compliance by municipal securities dealers. The amendments, in conjunction with the proposal's notice and comment period, will provide municipal securities dealers sufficient time to adopt and implement procedures to comply with the proposal.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the MSRB's Amendment No. 1. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the amendment that are filed with the Commission, and all written communications relating to the amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. § 552, will be available for inspection and copying in the Commission's Public Reference Section. Copies of the amendment also will be available for inspection and copying at the principal off ice of the MSRB. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from date of Publication].

VII. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the MSRB and, in particular, Section 15B(b)(2)(C).

IT IS THEREFORE ORDERED, pursuant to Section 19(b) (2) of the Act, that the proposed rule change and Amendment No. 1 described above be, and hereby are,

approved and shall be effective [insert date ten days after publication in the Federal Register][99]

By the Commission.

Jonathan G. Katz
Secretary

/s/ Margaret H. McFarland
By: Margaret H. McFarland
Deputy Secretary

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[99] The Commission simultaneously issued an order relating to this matter, "Order Preliminarily Declining to Issue Stay Sua Sponte and Establishing Guidelines for Consideration of Stay Applications." Securities Exchange Act Release No. 33870 (April 7, 1994).

APPENDIX C

SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 33870; File No. SR-MSRB-94-2

April 7, 1994

ORDER PRELIMINARILY CONSIDERING WHETHER TO ISSUE STAY SUA SPONTE AND ESTABLISHING GUIDELINES FOR SEEKING STAY APPLICATIONS

The Securities and Exchange Commission (the "Commission") is simultaneously herewith issuing an order approving a rule change proposed by the Municipal Rulemaking Board (the "MSRB").[1] The rule change implements Rule G-37 governing political contributions by municipal securities dealers and certain of their employees and amends Rules G-8 and G-9.[2]

The Commission understands that judicial review of this approval order will likely be sought. Indeed, on March 21, 1994 a complaint was filed in the United States District court for Middle District of Alabama, challenging the constitutionally of the MSRB proposal apparently under the mistaken assumption that the Commission already had approved the rule.[3] Although the Commission has moved to

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1 Securities Exchange Act Release No 33838 (April 7, 1994) (the "Approval Order").

2 The Approval Order describes in detail the various provisions of the MSRB rule change.

3 Blount, Parrish & Roton, Inc., et al. v. SEC, iv. Act. No. 94-A-345-N (M.D. Ala.).

dismiss this district court action as improperly filed,[4] it notes that the preliminary injunctive relief sought by plaintiffs is essentially the same as a stay of the rule's effectiveness.

The Commission has authority to grant stays in connection with petitions seeking review of a Commission order, and courts unless an application for a stay has first been made to the Commission. In connection with the Approval Order, the Commission preliminarily has considered sua sponte whether a stay of the effectiveness of some of all of the proposed rule change's provisions is appropriate in light of the constitutional concerns which have been raised by commentators, but has concluded for reasons discussed below that such relief is not warranted at this time. Nevertheless, this determination does not obviate the need for petitioners seeking a stay to mae an application to the Commission before seeking such relief n a court of appeals. In the event that applications are filed with the Commission, it will consider de novo such applications and, in the discussion below, ha identified certain considerations which should be addressed by review of such applications.

When evaluating the appropriateness of a stay under Section 25(c) of the Act, the Commission generally considers four factors: (1) whether there is a strong likelihood that a party will succeed on the merits in a proceeding challenging the particular Commission action (or, if the other factors strongly favor a stay, that there is a substantial case on the merits); (2) whether, without a stay, a party will suffer

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[4] Jurisdiction to review a Commission order approving an SRO rulemaking is vested, pursuant to Section 25(a) of the Act, exclusively in the United States courts of appeals.

irreparable injury; (3) whether there will be substantial harm to any person if the tay were granted and (4) whether the issuance of a stay would likely serve the public interest.[5] The evaluation of theses factors will vary with the equities and circumstances of each case.[6] However, when considering whether a stay should be granted sua sponte, the Commission's consideration of thee factors is necessarily truncated by the absence of particularized showing of harm by an applicant or an enumeration of specific deficiencies in the Approval Order. In understanding its analysis sua sponte, the Commission focuses only on the constitutional concerns that have been raised in connection with the rule change, because of the special nature of those concerns.

The MSRB rule change contains three functionally distinct provisions: a business disqualification provision, a solicitation and coordination provision, and disclosure and recordkeeping provisions. While the rule change;s provisions function as an integrated measure, the three types of provisions separately advance the rule change's prophylactic purpose of preventing improper and fraudulent activities by municipal securities dealers and certain of their employees. In approving the rule change, the Commission has treated the three types of provisions, and indeed is of the view that the MSRB intended that they be treated, as severable for purposes

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5 See e.g., Order Denying stay of Commission Order Approving Proposed Rule Change by the NASD, Exchange Act Release No. 33424, (January 5, 1994); see also Washington Metropolitan Area Transit Comm. v. Holiday Tours, Inc., 559 F.2d 841, 843 (D.C. Cir. 1977); Virginia Petroleum Jobbers v. FPC, 259 F.2d 921 (D.C. Cir. 1958).

6 Virginia Petroleum Jobbers, 259 F.2d at 925.

of review. Accordingly, in determining whether a stay is warranted, it is necessary to consider the four factors for each of the severable parts of the rule change.

1. The disclosure and recordkeeping provisions.

The commentators to the MSRB proposal did not identify any specific constitutional objections to the disclosure and recordkeeping provisions of the MSRB rule change—Rule G-37 sections (e)-(h) and the amendments to Rules G-8 and G-9. As a threshold matter, therefore, stay applicants would have to offer reasonable grounds for the failure to urge such objection before the Commission prior to its approval of the rule See Section 25(c)(1) of the Act. Even putting that matter aside, the Commission preliminarily is of the view that no substantial constitutional basis exists for challenging the disclosure and recordkeeping provisions. The disclosure and recordkeeping provisions represent at most marginal effects on associational rights under the First Amendment and certainly do not infringe on contributors' free communications. As the Supreme Court recognized in Buckley v. Valeo, 424 U.S. 1, 68 (1976),"disclosure requirements—certainly in most applications—appear to be the least restrictive means" of curbing illicit quid pro quo arrangements in connection with political contributions.

Moreover, the disclosure and recordkeeping requirements will not result in foreseeable irreparable harm to dealers or their associated MFPs (or, indeed, significant costs of any sort). Although the recordkeeping and disclosure provisions may result in some burden for dealers, such dealers are by virtue of existing Commission and MSRB regulations already subject in the ordinary course of business to significant recordkeeping and disclosure requirements and are

well-equipped to prepare and maintain records in compliance with the rule change. The Commission believes that a stay of the disclosure and recordkeeping requirements would harm the public, because the provisions permit monitoring of political contributions and advance important regulatory objectives, including the prevention of fraud, the promotion of just and equitable principals of trade and the protection of investors and the public interest.

Accordingly, it would appear as a preliminary matter that a sua sponte stay of the disclosure and recordkeeping provisions is warranted at this time.

2. The business disqualification provision.

As discussed in the Approval Order, the Commission believe that the business disqualification provision is supported by a compelling interest. In order to mount a successful First Amendment challenge to the provision, a petitioner must show that no compelling interest has bee adduced in support of the provision or that the provision is not sufficiently closely drawn to avoid unnecessary abridgments of speech and associational rights.

As previously notes, the Commission believes the provision serves a compelling interest. As to whether the provision is sufficiently closely drawn, the Commission considered and rejected in the Approval Order the objections raised by the commentators; the Commission does not believe the assertions that the rule change is not sufficiently narrow merit further analysis at this time.

Applicants arguably will be able to present a more cognizable claim of irreparable injury with respect to the

business disqualification provision as compared to the disclosure and recordkeeping provisions, if only in the sense that a colorable claim of a significant infringement of First amendment rights might give rise to irreparable injury.[7] The Commission notes, however that such a view if probably less appropriate here than in other circumstances. The alleged injury caused by the disqualification provision is not particularly severe, because other avenues of participation in municipal elections are not foreclosed. See Buckley, 424 U.S. at 21 (contributions limitations are at most "marginal restrictions" since they do not "in any way infringe on the contributor's freedom to discuss candidates and issues.").

Irreparable injury, moreover, is not sufficient by itself to warrant a stay, but typically must be accompanied by a strong showing with respect to the other factors.[8] In this regard, the Commission believes that there could be

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[7] Cf. Elrod v. Burns 427 U.S. 347, 373-74 (1976) (finding irreparable injury where employees not affiliated with political party were threatened with immediate loss of jobs because of non-affiliation; see also National Treasury Employees Union v. United States, 927 F.2d 1253 (D.C. Cir. 1991) (denying preliminary injunction with respect to constitutional challenge to honoraria ban in absence of showing that First Amendment interests are being impaired).

[8] See generally Washington Metropolitan Area Transit Com. v. Holiday Tours, Inc. 559 F.2d at 843; Cuomo v. NRC, 772 F.2d 972, 974 (D.C. Cir. 1985). Nor are municipal officials and candidates irreparably harmed by these provisions. The conduct of such officials is not regulated by Rule G-37 and, of course, they generally remain free to solicit and accept campaign contributions.

substantial harm to municipal securities market participants if a stay were granted. As discussed in the Approval Order, the Commission determined that Rule G-37 will serve important public interest concerns by contributing to the elimination of improper an fraudulent practices in the municipal securities market. Elimination of abuses will serve to promote market integrity and investor confidence. Moreover, permitting these practices to continue will adversely affect competing underwriters. Because application of the rule will avoid hardships to third parties and is in furtherance of the public interest, the balance of hardships does not appear to favor issuance of a sua sponte stay.

3. Solicitation and Coordination Provisions.

Many of the same considerations that apply in evaluating the propriety of a sua sponte stay with respect to the business disqualification provisions apply with equal force to the solicitation and coordination provisions. Although the solicitation and coordination provisions present somewhat different First Amendment issues, they are supported by a compelling governmental interest and apply only in those circumstances where a business relationship with a municipal issuer exists or is being sought. Moreover, in approving the rule change, the Commission construes the ban on solicitation narrowly as applying to explicit solicitations of contributions, and not to generalized solicitations of support for a candidate or his views. the Commission believes this construction is consistent with the MSRB's intent.

Challenges to the solicitation and coordination provisions conceivable could involve substantial First Amendment claims. Because the solicitation provision will be narrowly construed to apply only to the relatively specific

solicitation of contributions, however, the Commission is of the view that any irreparable injury would likely be slight in that the limitations would not affect the ability of dealers or their associated MFP's to engage in a free exchange of political views. Moreover, the Commission believes that the harm to third parties and the public interest from a stay are likely to be significant for the same reasons discussed in connection with the business disqualification provision. Accordingly, a stay as to the solicitation and coordination provisions does not appear to be warranted.

4. Applications Seeking a Stay of the Commission's Order

Although the commission believes it useful and expeditious to set forth its general view of issues related to a stay, the commission is aware that there may be relevant factors or considerations relating to a stay not raised in any of the comment letters. To facilitate the Commission's review of any application for a stay that may be made notwithstanding the foregoing discussion, the Commission believes that it is important that applications provide adequate explanations from which the Commission meaningfully can evaluate the asserted bases for the stay application. In particular, the Commission believes that as to legal claims raised by an applicant not previously raised before the Commission by either the applicant or other commentators, the applicant should provide an explanation for the failure to do so in the stay application. Applicants should identify the provisions of the rule change for which the stay is sought and the reasons in each case therefor. To the extent that the stay application rests on asserted deficiencies in the Commission's analysis, either with respect to the Commission's determination to approve the rule change or to refrain from

granting a stay sua sponte, such deficiencies should be identified with particularity. Further, all applicants also should describe with specificity the nature of any alleged harm or injury if the challenged portion of the MSRB rule change becomes effective.

The Commission also wishes to alert potential applicants and petitioners to certain procedural and timing requirements for determining which court of appeals will have jurisdiction in the event that review of the Approval Order is sought. If within ten days after issuance of this order the Commission receives, as specified in the Commission's Rules of Practice, 15 C.F.R. 201.23, court-stamped copies of petitions for review filed in more than one court of appeals, the Judicial Panel on Multidistrict Litigation will randomly select one of those courts to have jurisdiction over all cases challenging the order. See 28 U.S.C. 2112(a). If, within that a ten-day period, the Commission receives one or more petitions filed in only one circuit, that court of appeals will have jurisdiction over all cases challenging the rule. id. If no petition for review is received within the ten-day period, the court of appeals in which a petition for review if first filed will have jurisdiction. id. The ten-day window contemplated by Section 2112(a) commences upon entry of the Commission's order approving the rule change, rather than upon effectiveness of the rule. Persons who contemplate seeking review of the Commission's order should carefully review these provisions and the filing deadlines therein to preserve the possibility of jurisdiction in the court of appeals in which the petition is field.

Conclusion

The Commission has preliminarily determined that a sua sponte stay is not warranted with respect to any of the provisions of Rule G-37 and the amendments to Rule G-8 and G-9. In the event that an application to stay effectiveness of certain provisions of Rule G-37 and the amendments to Rules G-8 and G-9 is filed with the Commission, the Commission will consider the application de novo.

By the Commission.

Jonathan G. Katz
Secretary

/s/ Margaret H. McFarland
By: Margaret H. McFarland
Deputy Secretary

APPENDIX D

SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 34008; File No. SR-MSRB-94-2

May 4, 1994

ORDER DENYING APPLICATION OF WILLIAM B. BLOUNT FOR A STAY

On April 7, 1994, the Commission issued an order approving a rule change proposed by the Municipal Securities Rulemaking Board (the "MSRB").[1] The rule change implements Rule G-37 governing political contributions by municipal securities dealers and certain of their employees and amends Rule G-8 and G-9.[2] At the same time, the Commission issued an Order Preliminarily Considering Whether to Issue Stay Sua Sponte and Establishing Guidelines for Seeking Stay Applications (the "Preliminary stay Order").[3] In that order the Commission set forth the standards governing applications for a stay pending judicial review and set forth its preliminary analysis of whether a stay of the Approval Order should be granted. The Commission concluded "that such relief is not warranted at this time." The Commission noted, however, that "this determination does not obviate the need for petitioners seeking a stay to make an application to the Commission before seeking such

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1 Securities Exchange Act Release No. 33868 (April 7, 1994) (the "Approval order").

2 The Approval Order described in detail the various provisions of the MSRB rule change.

3 Securities Exchange Act release No. 33870 (April 7, 1994).

relief in a court of appeals. In the event that applications are filed with the Commission, it will consider do novo such applications."

Pursuant to the terms of the Approval Order the MSRB rules took effect on April 25, 1994. On that day William B. Blount applied to the commission for a stay of sections (b), (c) and (d) of rule G-37. These sections relate to two of the provisions in the rule, the business disqualification provision and the contribution solicitation and coordination provision.[4] Blount does not seek a stay of the this provision effected by the rule change, the disclosure and recordkeeping provisions contained in paragraph (e) of rule G-37 and in the changes to rules G-8 and G-9.

As the Commission noted in its Preliminary Stay Order, the three provisions are "severable for purpose of review."[5]

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[4] Section (b) contains the business disqualification provision. Section (c) contains the solicitation and coordination provision. Section (d) prohibits persons covered by the rule from "directly or indirectly, through or by any other person or means, do[ing] any act which would result in a violation of sections (b) or (c)."

[5] The Commission stated:

> While the rule change's provisions function as an integrated measure, the three types of provisions separately advance the rule change's prophylactic purpose of preventing improper and fraudulent activities by municipal securities

(continued...)

Accordingly, we will consider separately whether to stay each of the two challenged provisions, Sections (b) and (c).[6] We conclude for the reasons discussed in detail below that a stay is not warranted as to either provision.

We note at the outset that applicant's situation presents a particularly striking illustration of the need for the Rule. Applicant is a member of a firm which, he states, does substantial municipal securities business (as defined in the rule) for the state of Alabama and its political subdivision. He is also Chairman of the Alabama State Democratic Party. As such, he apparently engages in precisely the conduct that created the need for the rule—large-scale fundraising for state and local officials accompanied or followed by seeking business for his firm from those same officials. This is a

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[5](...continued)

dealers and certain of their employees. In approving the rule change, the Commission has treated the three types of provisions, and indeed is of the view that the MSRB intended that they be treated, as severable for purposes of review. Accordingly, in determining whether a stay os warranted, it is necessary to consider the four factors (governing whether to grant a stay) for each of the severable parts of the rule change.

[6] There is no need to deal separately with whether a stay of section (d) is warranted, since a stay of one or both of the other sections would effectively operate as a stay of section (d) as it applies to that section or sections. Applicant does not contend that if the Commission does not stay sections (b) or (c), it should nonetheless stay section (d).

situation that presents at the very least the appearance of inappropriate influence being brought to bear on who gets municipal securities business in the state.

Applicant contends that because he engages in a substantial amount of fund-raising and, at the same time, does a substantial amount of business with those for whom he raises funds, the MSRB rule will greatly burden him by forcing him to give up one or the other. While we do not believe that all of the applicant's concerns are well founded, he likely will be burdened by the rule in that he will no longer be able to engage simultaneously in incompatible fund-raising and municipal securities activities. If that burden proves to be a significant one, however, it is because applicant has an unusually pronounced conflict of interest.

As significant as the burden could be on this individual, we believe that a stay would adversely affect investors and other third party participants in the municipal securities markets, who rely upon the issuer to select the most qualified underwriter to conduct the due diligence necessary for their protection, and also would harm the public interest. We also do not believe that applicant has made out a case that he is likely to prevail on review of the Approval Order. Accordingly, we do not believe a stay is warranted.

5. Alleged Irreparable Harm and Likelihood of Success on the Merits as to Section (b) of the Rule, the Business Disqualification Provision

A. Irreparable Harm

Applicant offers no persuasive reason why the business disqualification provision contained in Section (b) should be stayed. He asserts that he is a municipal securities professional, such that contributions he makes to officials would preclude him and his firm for two years thereafter from obtaining municipal securities business over which those officials have influence. He further asserts that "[b]ecause virtually every Alabama constitutional officer is an 'official of an issuer,' Blount must abandon his First Amendment right to make contributions if he seeks to continue his profession as a dealer in municipal securities."

Applicant suffers no harm at all to his expressive rights as to contributions to candidates that are running for state-wide constitutional office, since he presumably is entitled to vote for them and thus may contribute up to $250 to each such official. This limit would not impede applicant's ability to express support for these candidates. The giving of money is a symbolic expressive act, but the quantity of communication from the act "does not increase perceptibly with the size of his contribution." Buckley v. Valeo, 424 U.S. 1, 21 (1976). We do not believe that applicant has shown he would suffer any perceptible irreparable injury to his First Amendment rights from this restriction as it might effect his contributions to these officials.

He also cannot show substantial harm as to contributions to candidates for whom he would not be entitled

to vote, even though a contribution of any amount to such a candidate could trigger the business disqualification provision. While this may impose a somewhat greater burden on applicant's ability to engage in the symbolic act of contributing, it does not significantly infringe on his right to express support for these candidates. The Supreme Court has recognized that giving a candidate money is not the same as discussing issues or debating qualifications which are entitled to greater protections: "[a] contribution serves as a general expression of support for the candidate and his views, but does not communicate the underlying basis for the support." Buckley, 424 U.S. at 20. To the extent this restriction might be viewed as causing applicant irreparable injury, that injury is marginal.[7] At any rate, even a significant interference with rights protected by the First Amendment may be justified by a sufficiently compelling governmental interest so long as the interference is closely drawn to avoid unnecessary abridgment of those protected rights. Buckley, 424 U.S. at 25.

Applicant's central claim as to irreparable harm is that he could also be precluded from directing which officials get contributions from the Democratic Party. He asserts that after raising money for the Democratic Party in Alabama, "[t]he money raised is contributed at my discretion, as Chairman of the Alabama Democratic Party, to candidates who need it . . .."

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[7] The applicant also claims that his family will be unable to contribute to candidates. But that will only be so if he is directing their contributions, thus seeking to evade the rule's provisions.

Should applicant be compelled to cede those duties to another party official, however, it would not constitute a serious infringement on his First Amendment rights. His activities are, from his standpoint, no different than if he wished to give large donations personally. The fact that he might be precluded from doing so as party chairman constitutes no greater infringement of his rights of expression than does a restriction on his personal contributions.[8]

A. Likelihood of Success on the Merits

In light of the marginal restriction this provision would impose on applicant's rights to expression, we think he must make a strong showing of a likelihood of success on appeal. We do not believe he has shown that. As we explained in our Approval Order, the business disqualification provision operates to ensure that negotiated underwriting and other non-competitive municipal securities business is freed from the taint and the appearance of taint that follows when municipal securities dealers and municipal finance professionals give political contributions to those with influence over whether they are awarded business. The concern that political contributions can distort the award of public contracts is a common one. The business

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[8] Although applicant claims that as a result of these provisions he could be forced to give up his job as state party chairman, we are unaware of any constitutional right he has to serve on that particular job. Applicant does not claim that the rule would in any respect preclude the party from making contributions. He does claim that he has not trained anyone else to do these tasks, but he has been on notice since at least January that this rule might be imposed.

disqualification provision, far from being a novel species of restriction, is akin to similar prohibitions on political contributions by government contractors under both federal and state law. See approval Order at 34-35 & nn. 67 & 68.

Applicant suggests, however, that the public interest is not compelling here because the Commission's concern is with the integrity of the municipal finance markets, rather than with the integrity of the political process. The municipal securities markets, and those who deal in those markets, are highly regulated precisely because there is a strong public interest in the fair, honest, and efficient operation of the markets. The fact that the commission does not regulate state elections does not mean that there is no compelling interest on the part of the Commission or MSRB in regulating contributions made by dealers and municipal securities professionals to officials who are in a position to influence the award o municipal securities business.[9] Because the preservation of the integrity of those markets is of compelling public importance, the influence of contributions in state and local elections on the award of municipal securities business is a matter of high public concern within the Commission's jurisdiction.

While applicant challenges whether there actually is a problem from these "pay-to-play" practices, there is a more than adequate factual basis for concluding that it is a serious problem. The Supreme Court has acknowledged that "the

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[9] Cf. 15 U.S.C. 791(h) (prohibiting contributions by public utility holding companies and their subsidiaries to candidates for state office); 2 U.S.C. 441b(c) (prohibiting national banks from making contributions to state elections).

scope of such pernicious practices" as quid pro quo exchanges of contributions for factors "can never be reliable ascertained.: and has not required a definitive factual showing a precondition to contribution limitations. Buckle v. Valeo, 424 U.S. 1, 27 (1976).

In approving the rule, we cited abundant evidence that pay-to-play in many instances is and has come to be considered an ordinary cost associated with obtaining municipal underwriting business. See Approval Order at 8-15. The MSRB, which is composed of embers of the municipal securities industry and others, ha been concerned with the problem for several years. See Approval Order at 12-13.[10] Over 50 municipal securities dealers have agreed to adhere to a voluntary Statement of Initiative providing that political contributions made, in any manner, for the purpose of influencing the awarding of municipal finance business should be prohibited. Approval Order at 14. In response, notably, some government officials have urged that firms that comply with those guidelines be boycotted. See id. at 14 n.40.[11] The numerous comments received by both the

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[10] The Commission's Decision of Market Regulation has described the seriousness of the problem and has recommended regulation. United States Securities and Exchange Commission, Division of Market Regulation, Staff Report on the Municipal Securities Market, 9-11, 32-34 (1993).

[11] Applicant's statement that the implementation of the disqualification "will dramatically affect" the "dynamics of state and local elections," Stay Memorandum at 25, appears to be a concession that underwriter funds are an important

(continued...)

MSRB and the commission from participants in all phases of the municipal securities market were in near unanimous agreement that pay-to-play, and the public perception of pay-to-play, are significant problems.[12]

Finally, applicant argues that even if there is a problem, narrower solutions, such as only restricting contributions given for the purpose of influencing the awarding of contracts, or relying on disclosure alone, would be sufficient. As the Supreme Court explained in rejecting similar arguments in Buckley, 424 U.S. at 27-28, bribery laws deal "only with the most blatant and specific attempts of those with money to influence government action," and, while disclosure serves salutary purposes, it is reasonable to conclude that "disclosure was only a partial measure" and that contribution limitations are necessary to deal with "the reality

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[11](...continued)

factor in many such elections. But it is hard to argue that a restriction on contributions will "dramatically affect" elections while at the same time asserting that there is no basis for public suspicion that the award of municipal securities business is often influenced by those contributions.

[12] There were criticisms of the rule, but very little disagreement that there is a problem. The only commentator applicant cites to raise a doubt that the problem is significant is the representative of the state officials who receive the contributions, and even he said only that "there have been relatively few reported instances of improper behavior in the market." Stay Memorandum at 14 n.7 (emphasis added).

or appearance of corruption inherent" even when disclosure is required.[13]

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[13] Applicant also suggests that the rule violates the equal protection component of the due process clause of the Fifth Amendment. Stay Memorandum at 22 n.9. It is certainly rational to conclude that the central role municipal securities dealers play in the municipal securities market justifies distinguishing between them and other participants. Applicant asserts that banks and bank holding companies are allegedly "unaffected by Rule G-37" because they may make contributions through divisions other than the municipal securities division. The important point which applicant overlooks is that the municipal securities division of a bank may not use the other divisions to make such contributions because that would be an indirect violation of the rule, prohibited by paragraph (d). It wa the Commission's judgment, pending experience with the rule, that this would be a sufficient safeguard. Approval Order at 42-44. Applicant asserts that the rule treats similarly situated individuals differently with regard to the exercise of fundamental speech and association rights and that the distinctions drawn by the rule must therefore be tailored to serve a substantial government interest. For the reasons given in discussing applicant's First Amendment Claims, we believe the rule passes muster under the equal protection clause as well. See 3 R. Rotunda and J. Nowak, Treaties on Constitutional Law: Substance and Procedure, section 18.40 (laws that survive substantive review under the specific guarantees of the First Amendment are also likely to be upheld under an equal protection analysis, for they have already been found to represent the promotion of governmental values which override the individual interest in the specific right).

2. Alleged Irreparable Harm and Likelihood of Success on the Merits a to Section (c) of the Rule, the Solicitation and Coordination Provision.

A. Irreparable Harm

Applicant's primary concerns appear to be with respect to the solicitation and coordination provision contained in Section (c) of the Rule. That provision prohibits affected persons from soliciting any person or political action committee to make any contribution, or from coordinating any contributions to officials of certain issuers. However, it only applies to issuers "with which the broker, dealer, or municipal securities dealer is engaging or is seeking to engage in municipal securities business" at the time of the solicitation or coordination.[14]

Beyond making the arguments discussed above, the applicant claims that his First Amendment rights will be impaired in numerous ways as a result of this provision. Many of these contentions simply overstate the scope of the provision. We reiterate our statement in our Preliminary Stay Order that we "construe[] the ban on solicitation narrowly as applying to explicit solicitations of contributions, and not to

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[14] Thus, the provision is narrower than the business disqualification in that the disqualification applies for two years to any covered business over which an official to whom a contribution is made has influence. The solicitation and coordination provision arguably is broader than the business disqualification provision in that it contains no exception for official for whom the affected persons may vote.

generalized solicitations of support for a candidate or his views." Thus, applicant's concern that the provision could be triggered by inadvertently using the word "money" in a speech urging support for a candidate, or simply by making a speech of general support for a candidate, or simply by making a speech of general support at a fund-raising affair, is misplaced. Likewise, his contention that soliciting money for his political party will necessarily trigger the provision is incorrect. Soliciting money is prohibited only where the person making the solicitation knows that the funds will be directed by the party toward a specific official and his firm is engaged in or seeking to engage in municipal securities business with an issuer in which the official can influence the awarding of business.

We do not doubt, however, that some of applicant's activities could trigger this provision. To the extent that applicant knows he is soliciting money for specific candidates, rather than for the party in general, his activities would be covered. This may compel the applicant to give up some of his fund-raising activities or give up some of his municipal securities businesses. If as a result he must give up significant fund-raising activities, it is because the applicant has a significant conflict of interest. Simply put, by his own account he spends a substantial amount of time raising large sums of money which he then awards, in his discretion, to candidates for public office. He then seeks public contracts from those same officials. If the activities applicant must relinquish are greater than typical it is because his conflict of interest is more profound than is typical. The burden on him

is commensurate with the compelling public interest the provision weeks to address.[15]

We believe that this restraint on applicant's activities would constitute at most a marginal restraint on his ability to engage in expressive conduct. Applicant is not disabled from speaking in support of any official or candidate. He may speak at any time in support of any such person. He may make independent expenditures on behalf of the candidate. He may solicit money to be used for independent expenditures. All that he cannot do is solicit money on behalf of the candidate. Applicant fails to show how the act of soliciting money significantly expand on the message he can otherwise send. Just as a contribution of money is only a generalized expression of support, a solicitation of money by itself is no more than a generalized statement that this candidate is worthy of support, something he can readily state directly.

B. Likelihood of Success on the Merits

We do not believe that applicant has raised a sufficient question on the merits to warrant a stay. As we have construed the provision, it applies only to circumstances where a person is specifically soliciting contributions to an official and his firm is engaged or seeking to engage in

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[15] Applicant could even have to step aside as party Chairman, if the job cannot be retailored and if he is unwilling to curtail some of the municipal securities business (limiting it, for example, to competitive underwriting and other competitive activities not covered by the rule). But a we noted above, applicant does not have a First Amendment right to be party chairman.

municipal securities business with an issuer in which the official can influence the awarding of business. Like the business disqualification provision discussed above, it addresses direct conflicts of interest. It does not preclude persons from expressing support for officials or urging that others support them. Applicant is left with his First Amendment rights intact. We believe that this restriction is justified by the compelling interest in eradicating conflicts of interest in the municipal securities business.

In disputing that, applicant claims that the solicitation and coordination provision is "unprecedented" as applied to a private citizen. This implicitly recognized that similar restrictions (in fact restrictions which are more onerous) have been upheld as imposed on federal and state employees.[16] The fact that solicitation bans have been upheld as to government employees indicates that such restrictions may be imposed if there is a sufficiently compelling public interest.

We do not believe that the problems we have identified can be eradicated through less restrictive means. We have discussed several of those mean above. Beyond that, we do not believe that the problem could be eradicated solely through the business disqualification provision. Although that provision is severable from the solicitation and coordination provision, the restriction on soliciting and coordinating contributions works to make the business contribution ban fully effective. If regulated persons can

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16 See, e.g., United States Civil Service Commission v National Association of Letter Carriers, 413 U.S. 548, 555 (1973) (Among activities that can be prohibited is "actively participating in fund-raising activities for a partisan candidate or political party").

provide financial support to state and local officials by soliciting or coordinating contributions from others, the fact that they personally are prohibited from making contributions will be of considerably less significance.

3. Effect of a Stay of the Challenged Provisions on third Parties and the Public Interest

As to the remaining factors, we believe, for the reasons stated in the Preliminary Stay Order, that there could be substantial harm to municipal securities market participants and to the public interest if a stay of either provision were granted.

Conclusion

For the foregoing reasons, a stay of the Approval Order is not warranted with respect to sections (b), (c), or (d) of Rule G-37.

By the Commission.

Jonathan G. Katz
Secretary

/s/ Margaret H. McFarland
By: Margaret H. McFarland
Deputy Secretary

APPENDIX E

UNITED STATES COURT OF APPEALS

For the District of Columbia Circuit

No. 94-1336 **September Term, 1993**

William B. Blount,
Petitioner

[File stamp]
v. May 06 1994

Securities and Exchange Commission,
Respondent

BEFORE: Mikva, Chief Judge*; Edwards and Randolph, Circuit Judges

O R D E R

Upon consideration of the emergency motion for stay pending review, the responses thereto, and the reply; and the Municipal Securities Rulemaking Board's ("MSRB") motion for leave to intervene, it is

ORDERED that the motion for leave to intervene be granted. The Clerk is directed to file the lodged amended opposition to the emergency motion for stay. It is

FURTHER ORDERED that the emergency motion for stay be granted with respect to paragraph (c) of MSRB Rule G-37 and that portion of paragraph (d) insofar as it concerns the solicitation of contributions. This partial stay is granted only to the extent MSRB Rule G-37 applies to petitioners. With respect to the solicitation provisions, petitioner has satisfied the standards required for a stay pending court review. See Washington Metropolitan Area Transit Commission v. Holiday Tours, Inc., 559 F.2d 841 (D.C. Cir.

1977); D.C. Circuit Handbook of Practice and Internal Procedures 66-69 (1994). It is

FURTHER ORDERED that the motion for stay be denied with respect to paragraph (b) of MSRB Rule G-37 and that portion of paragraph (d) insofar as it concerns making contributions. With respect to the contribution provisions, petitioner has not demonstrated the requisite irreparable injury to warrant the issuance of a stay pending review. It is

FURTHER ORDERED, on the court's own motion, that the following briefing schedule shall apply:

Petitioner's Brief and Appendix	June 1, 1994
Respondent's Brief	July 1, 1994
Intervenor's Brief	July 18, 1994
Petitioner's Reply Brief	August 1, 1994

Oral argument will be heard at the earliest possible date following completion of the briefing.

Per Curiam

/s/ AJM
/s/ HTE
/s/ ARR

* Chief Judge Mikva would deny the emergency motion for stay in its entirety.

APPENDIX F

UNITED STATES COURT OF APPEALS
For the District of Columbia Circuit

No. 94-1336 **September Term, 1993**

William B. Blount,
Petitioner

v.

[File stamp]
OCT - 4 1995

Securities and Exchange Commission,
Respondent

Municipal Securities Rulemaking Board,
Intervenor

BEFORE: Williams, Henderson and Rogers, Circuit Judges

ORDER

Upon consideration of Petitioner's Petition for Rehearing filed September 18, 1995, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
By: /s/ Linda Jones
Linda Jones
Deputy Clerk

UNITED STATES COURT OF APPEALS
For the District of Columbia Circuit

No. 94-1336 **September Term, 1995**

William B. Blount,
Petitioner

v.

[File stamp]
OCT - 4 1995

Securities and Exchange Commission,
Respondent

Municipal Securities Rulemaking Board,
Intervenor

BEFORE: Edwards, Chief Judge, Wald, Silberman, Buckley, Williams, Ginsburg, Sentelle, Henderson, Randolph, Rogers, and Tatel, Circuit Judges

ORDER

Upon consideration of Petitioner's Suggestion for Rehearing In Banc, and the absence of a request by any member of the court for a vote, it is

ORDERED that the suggestion be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
By: /s/ Linda Jones
Linda Jones
Deputy Clerk

APPENDIX G

STATUTORY AND REGULATORY PROVISIONS

15 U.S.C. § 78*o*-4 (in relevant part):

> (b) Municipal Securities Rulemaking Board; rules and regulations
>
> . . .
>
> (2) The Board shall propose and adopt rules to effect the purposes of this chapter with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers. (Such rules are hereinafter collectively referred to in this chapter as "rules of the Board".) The rules of the Board, as a minimum, shall:
>
> . . .
>
> (C) be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, municipal securities brokers, or municipal securities dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be

charged by municipal securities brokers or municipal securities dealers, to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the Board, or to impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

15 U.S.C. § 78*s* (in relevant part):

Proposed rule changes; notice; proceedings

(b)(1) Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

Rule G-37, which is reprinted in full at JA 644-50, provides in relevant part:

> (b) No broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the broker, dealer or municipal securities dealer; (ii) any municipal finance professional associated with such broker, dealer or municipal securities dealer; (iii) any political action committee controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional; provided, however, that this section shall not prohibit the broker, dealer or municipal securities dealer from engaging in municipal securities business with an issuer if the only contributions made by the persons and entities noted above to officials of such issuer within the previous two years were made by municipal finance professionals to officials of such issuer for whom the municipal finance professionals were entitled to vote and which contributions, in total, were not in excess of $250 by any municipal finance professional to each official of such issuer, per election.
>
> (c) No broker, dealer or municipal securities dealer or any municipal finance professional of the broker, dealer or municipal securities dealer shall solicit any person or political action committee to make any contribution, or shall coordinate any contributions to an official

of an issuer with which the broker, dealer or municipal securities dealers is engaging or is seeking to engage in municipal securities business.

(d) No broker, dealer or municipal securities dealer or any municipal finance professional shall, directly or indirectly, through or by any other person or means, do any act which would result in a violation of sections (b) or (c) of this rule.